The Law Commission

Working Paper No. 73

Insurance Law
Non-disclosure and breach of warranty

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THE LAW COMMISSION

Working Paper No. 73

Insurance Law

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THE LAW COMMISSION

INSURANCE LAW

PART I - INTRODUCTION

Terms of reference

1. On 17 May 1978 the Lord Chancellor referred certain aspects of insurance law to the Law Commission, under section 3(1)(e) of the Law Commissions Act 1965, with the following terms of reference:

> "To consider the effect on the liability of an insurer, and on the rights of an insured, of:
>
> (a) non-disclosure by, or on behalf of, the insured;
>
> (b) misrepresentation by, or on behalf of, the insured;
>
> (c) breach of 'warranty' by the insured;
>
> (d) special conditions, exceptions and terms;
>
> (e) increase and decrease of risk covered,
>
> particularly in the light of the Fifth Report of the Law Reform Committee (1957) and the draft E.E.C. Directive on the co-ordination of laws, regulations and administrative provisions relating to insurance contracts, and to make recommendations."

2. We are publishing this working paper as a basis for consultation on the reform of the law as to non-disclosure by the insured and as to breach of warranty by the insured. We are aware that other parts of insurance law falling within our terms of reference may be in need of reform. However, we have been asked to consider these two major topics as a matter of urgency and we have therefore left over for the time being the consideration of any other matters.

The Fifth Report of the Law Reform Committee[1]

3. In July 1954 the then Lord Chancellor invited the Law Reform Committee to consider the effect on the liability of insurance companies of special conditions and exceptions in insurance policies and of non-disclosure of material facts by persons effecting such policies. In January 1957 a short report was published (hereafter referred to as "the report") in which the Committee summarised the practical effects of the matters referred to them[2] and considered whether the situation disclosed was such as to require amending legislation.[3] The Committee reported that the state of the law, combined with the use by insurers of certain types of special conditions and exceptions in policies, was capable of leading to abuse in the sense that a variety of circumstances might entitle insurers to repudiate liability as against an honest and at least reasonably careful insured and, furthermore, that such abuses had in fact sometimes occurred, though not to any substantial extent.[4] The Committee accepted the accuracy of the representations made by the insurance industry to the effect that no reputable insurer would rely on a technical defence to defeat an honest claim but stated that this did not alter the fact that in many cases an insurer was in a position to substitute his own judgment of the claimant's bona fides for that of a court.[5] However, they considered that the mere fact that the law was theoretically open to criticism and susceptible to abuse did not justify a recommendation that it should be changed, especially where the prejudice to the insured arose from

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1 (Conditions and Exceptions in Insurance Policies) (1957) Cmnd. 62.

2 Ibid., paras. 4-10.

3 Ibid., paras. 11-14.

4 Ibid., paras. 11-12.

5 Ibid., para. 11

express contractual provisions rather than from rules of law as such. The Committee took the view that legislation to alleviate the position of the insured would involve interference with the liberty of contract of the insurer and that the desirability of such legislation was a broad question of social policy outside their competence.[6] Nevertheless, the Committee did consider to what extent it was practicable to introduce new provisions into the existing law and what form such provisions should take. Indeed, they formulated three provisions which in their view could be introduced into the law without giving rise to legal difficulties in their application. The first of these provisions is particularly relevant to this working paper:

> "that for the purposes of any contract of insurance no fact should be deemed material unless it would have been considered material by a reasonable insured".[7]

In devising our scheme for reform of the law we have paid close attention to the report and in particular to the provision just referred to.

The Statements of Insurance Practice

4. On 4 May 1977, following discussions between representatives of leading insurers and the Government, the Parliamentary Under-Secretary at the Department of Trade announced in the House of Commons[8] that the British Insurance Association and Lloyd's had drawn up a statement of practice (hereafter referred to as the Statement of Insurance Practice) which they were recommending to their members. The Statement of Insurance Practice is restricted to non-life insurances of policy holders resident in the United Kingdom and insured in their "private" capacity only. On 28 July

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6 Ibid., para. 12.

7 Ibid., para. 14.

8 Hansard (H.C.), 4 May 1977, vol. 931, cols. 217-220.

1977 an announcement was made to the House of Commons[9] that a Statement of Long-Term Insurance Practice had been drawn up by the Life Offices' Association and Associated Scottish Life Offices. This Statement has also been accepted by the Linked Life Assurance Group. It relates to long-term insurance effected by individuals resident in the United Kingdom in their "private" capacity. In practice this means that the Statement is applicable principally to life assurance which is the only type of long-term insurance generally available in this country. The Statements arose from concern that in view of the proposed exclusion of insurance contracts from the Unfair Contract Terms Bill (subsequently enacted as the Unfair Contract Terms Act 1977 with insurance contracts still excluded) insurance policy holders might not be afforded sufficient protection from unfair treatment as a result of the terms of insurance contracts. Both these Statements are reproduced in Appendix A. We deal with each Statement in turn and then make some general comments.

(a) The Statement of Insurance Practice of 4 May 1977

5. Paragraph 1(b) of the Statement of Insurance Practice provides that a statement should be prominently displayed on the proposal form informing the proposer of the nature of his duty of disclosure and of the consequences of his failure to comply with it. Paragraph 3 requires insurers to warn an insured about his duty of disclosure in renewal notices. The proposal form should also contain a warning that if a proposer is in any doubt whether a fact is material he should disclose it.[10] Paragraph 1(c) provides that those matters which insurers have found generally to be material should be the subject of clear questions in the proposal form and paragraph 1(f) requires the insurer to send the insured a copy of the completed proposal form if the insurer raises an issue concerning it, unless a copy has already been supplied to him.

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9 Hansard (H.C.), 28 July 1977, vol. 936, cols. 641-644.

10 Para. 1(b).

6. Paragraph 2(b) indicates that, except where fraud, deception or negligence is involved, an insurer will not unreasonably repudiate liability to indemnify a policy holder in the following circumstances:

(i) where the insured has failed to disclose a material fact (or there has been a misrepresentation of such a fact) but knowledge of the fact would not materially have influenced the insurer's judgment in the acceptance or assessment of the insurance;

(ii) where there has been a breach of warranty or condition but the circumstances of the loss are unconnected with the breach.

This paragraph does not apply to marine or aviation policies.

(b) The Statement of Long-Term Insurance Practice of 28 July 1977

7. Turning now to the Statement of Long-Term Insurance Practice, paragraph 1(a) indicates that an insurer will not unreasonably reject a claim and in particular that a claim will not be rejected for the non-disclosure or misrepresentation of a matter that was outside the proposer's knowledge. However, a proviso states that fraud or deception will, and negligence or non-disclosure or misrepresentation may, result in "adjustment" or constitute grounds for rejection. Paragraph 2 of the Statement makes provisions concerning the content of proposal forms similar to those made in the Statement of Insurance Practice of 4 May 1977.

(c) General comments

8. The scope of both Statements is somewhat uncertain: some difficulty is caused by the words "in a private capacity" in both Statements, although it seems that the Statements are only intended to benefit persons effecting insurance otherwise than in the course of their business.

9. The provision in both Statements that insurers will not "unreasonably" repudiate liability or reject a claim leaves insurers as the sole judges of whether repudiation or rejection is unreasonable in any given situation. We believe that this is unsatisfactory. In the Statement of Insurance Practice this drawback is exacerbated because no indication is given of the cases in which repudiation will be unreasonable. The application of both Statements is limited to the members of the organisations which were party to them or which subsequently accepted them;[11] there are, however, insurance underwriters in the United Kingdom who are not members of these organisations.

10. But there is a more important criticism that can be made of the Statements of Practice: they are both measures of self-regulation by the insurance industry lacking the force of law. An insured would therefore have no legal remedy if the insurer failed to act in accordance with their provisions. Although we do not doubt that the insurers to whom the Statements apply intend to abide by their provisions, there is no certainty that they would actually do so in all cases. Indeed a liquidator of an insurance company would be bound to disregard the Statements. Our view is that if the insured needs further protection, and it seems to be widely accepted that he does, then it should be provided by legislation. It will be noted hereafter that many of our provisional recommendations follow lines broadly similar to the provisions in these Statements of Practice.

The draft directive

11. Work is being done at the Commission of the European Communities in Brussels on a directive on the co-ordination of the legislative, statutory and administrative

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11 The British Insurance Association and Lloyd's in respect of the Statement of Insurance Practice and the Life Offices' Association, the Associated Scottish Life Offices and the Linked Life Assurance Group in respect of the Statement of Long-Term Insurance Practice. The latter Statement will be modified in its application to industrial life assurance policy holders who are already protected by the Industrial Assurance Acts 1923 to 1968 and regulations made thereunder. See Appendix A at p. 111 especially second para. of the introduction to the Statement of Long-Term Insurance Practice.

provisions governing insurance contracts. A fifth draft of the directive has now been produced. For convenience we shall refer to it simply as the "draft directive". Articles 2, 3 and 4 of the draft directive, which are relevant to this working paper, are reproduced as Appendix B. The draft directive originally arose from the 1975 version of the draft "services" directive,[12] Article 5 of which called for the harmonisation of "essential provisions"[13] of the insurance contract law of Member States within three years of its notification.[14] Although Article 5 has been omitted from the latest draft of the "services" directive, Article 4(1) of that draft continues to provide that harmonisation of "the law governing contracts of insurance" must occur within three years of its notification. Despite the use of the wider phrase, the draft directive has at present as its main aim the harmonisation only of the "essential provisions" mentioned in the earlier draft of the "services" directive.

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12 Draft Second Council Directive on the Provision of Insurance Services within the E.E.C. The purpose of this directive is to enable an insurance undertaking established in any Member State of the E.E.C. to provide services elsewhere in the Community without having an establishment in the Member State where the insurance is provided. It makes different provisions for different kinds of risk and, in particular, lays down choice of law rules for each kind of risk.

13 Putting it shortly, these provisions relate to the insured's duty to disclose facts material to the risk, both before and after the making of the contract, the payment of the premium and the consequences of non-payment, the duties of the insured in the event of a loss, the circumstances in which the contract may be avoided and the rights of third parties.

14 Article 5 of the 1975 draft provided for the application to certain insurance contracts of "essential provisions" of the law of the Member State in which the risk covered was situated, notwithstanding the parties' choice of another law for this purpose.

12. The proposals in the draft directive are not at this stage necessarily acceptable to the Commission of the European Communities or to the governments of Member States. However, if implemented they would require far-reaching changes in our present law to be made by legislation. Articles 2, 3 and 4 therefore fall to be considered as one alternative way of reforming that part of our present law which comes within the scope of this working paper. Later in this working paper[15] we shall therefore consider these Articles in some detail and express our preliminary views on them. There is some uncertainty as to the territorial scope of the draft directive.[16] However, we shall assume that, if the provisions of the draft directive come into force in any form, they will replace for all purposes the rules of our present law which we are discussing in this working paper.

13. Although only Articles 2, 3 and 4 of the draft directive fall within the scope of this working paper, so that we shall not be dealing with the remaining Articles of the draft directive, it may become necessary at a later date for us to discuss some or all of the remaining Articles of the present draft and any Articles which may be added or substituted in any further draft.

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15 See Part IV, passim.

16 Two earlier directives adopt differing approaches in this regard. The First Council Directive of 24 July 1973 on the Establishment of Insurance Undertakings in the E.E.C. applies to the establishment of all insurance undertakings in the E.E.C. no matter where the risks they are to cover are situated. On the other hand, the draft "services" directive only applies to the provision of services in relation to risks situated within the E.E.C. As we have seen in paragraph 11 above, the need for the draft directive stems from the negotiations on the draft "services" directive and it may be that it is intended to be equally limited in scope i.e., to risks situated within the E.E.C.

The scope of the working paper

14. It will be seen that our terms of reference do not exclude any particular types of insurance cover from our consideration, nor do they exclude the problems raised by insurance intermediaries. However, the Law Reform Committee excluded marine insurance from the scope of its enquiry[17] and the draft directive does not apply to life insurance. The Law Reform Committee also considered the problems raised by the activities of insurance intermediaries.[18] We must therefore consider whether these topics should be dealt with in this working paper.

(a) Marine, aviation and transport insurance[19]

15. It is convenient to look at marine, aviation and transport insurance ("MAT") together since similar considerations of policy apply to each of them. The Law Reform Committee stated:[20]

> "At an early stage we decided to exclude marine insurance from the scope of our enquiry. The general public is not interested in marine insurance and we have no reason to believe that the business circles who are concerned with the subject are in any way dissatisfied with the law as it stands".

Although members of the general public may occasionally obtain marine insurance, for example to cover articles being shipped abroad,[21] in the vast majority of cases it is the trader, shipowner and aircraft owner rather than the private individual

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17 See their Fifth Report (1957) Cmnd. 62 at para. 3.

18 Ibid., at paras. 7 and 14(3).

19 "Marine, aviation and transport insurance business" is defined extensively by the Insurance Companies Act 1974, s. 83(4).

20 Fifth Report (1957) Cmnd. 62, para. 3.

21 Such individuals would be protected to some extent by the Statement of Insurance Practice of 4 May 1977: see paras. 5-6, above.

who seeks MAT. MAT policy holders are therefore generally professionals who carry on business in a market governed by long-standing and well-known rules of law and practice. Consequently the necessity to protect the insured, which was of great importance to us in formulating provisional proposals for reform of this branch of the law, is to that extent less relevant for MAT.

16. This of itself would not have prevented us from making provisional recommendations for reform of the law relating to MAT if there were grounds for believing that it was unsatisfactory. However, we have no grounds for such a belief.[22] The Marine Insurance Act 1906, together with subsequent case-law, contains comprehensive provisions which provide a context of certainty of law and practice in this country especially in relation to the conduct of international commerce. This basis of legal certainty has helped to establish London as the leading international market for MAT and our insurance law and practice have been adopted by many other trading nations. The highly competitive nature of the international market for MAT makes this a highly relevant consideration.

17. Taking all these considerations into account, we have decided not to deal with MAT in this working paper. We understand that the final version of the draft directive is also unlikely to apply to MAT.[23]

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22 R.A. Hasson, in his article "The doctrine of uberrima fides in insurance law - a critical evaluation" (1969) 32 M.L.R. 615 at 635 states "... it is submitted that any reforming provisions ... should not cover the law relating to marine insurance. Both the law and the practice in this area ... appear to work satisfactorily and there would appear to be every argument for leaving well alone in this area".

23 However, the definition of MAT, for the purposes of its exclusion from the draft directive, is slightly different from that contained in the Insurance Companies Act 1974 and referred to in n. 19 above, although it is understood to be likely that the 1974 Act will be amended so as to bring the two definitions into line.

(b) Life insurance

18. On the other hand, we see no good reason to exclude life insurance from this working paper. The considerations of policy which have influenced us in making our provisional proposals for reform are in our view applicable to life insurance. The draft directive, like the other directives to which it is related,[24] does not apply to life insurance which is the subject of quite separate discussions within the E.E.C., which are less well advanced. The main reasons for the separate treatment of life insurance relate to the nature of the problems involved in the supervision of the insurance industry in different countries. This reason for its exclusion is in no way relevant to this working paper. Accordingly, the provisional recommendations in this working paper are intended to apply to life insurance.

(c) Insurance intermediaries

19. Our terms of reference are wide enough to cover the effect on the liability of insurers of the negotiation of insurance contracts by agents or brokers, because under the present law such intermediaries are for some purposes regarded as the agents, not of the insurer, but of the insured.[25] The problem arises because the insured is likely to assume that a disclosure of all material facts to such an intermediary is disclosure to the insurer. An insurer may nevertheless repudiate a policy on the ground of non-disclosure by the insured where an intermediary, whom the insured has allowed to complete his proposal form, has for some reason failed correctly or fully to incorporate the oral information supplied to him or where a broker has failed to pass on such information to the insurers. This defect in the present law was referred to

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24 See n. 16, above.

25 Newsholme Bros. v. Road Transport and General Ins. Co. Ltd. [1929] 2 K.B. 356; Anglo-African Merchants Ltd. and Exmouth Clothing Co. Ltd. v. Bayley [1970] 1 Q.B. 311, 322 per Megaw J.

by the Law Reform Committee[26] and our preliminary view is that this area of the law is probably in need of reform. In January 1977 the Government published a White Paper on the whole question of insurance intermediaries[27] in which the introduction of a new framework of control over the whole field of insurance selling by brokers and agents was recommended.[28] These controls, by making insurers fully responsible for the conduct of intermediaries, would have the effect of substantially curing the defect to which we have just referred. Parliament has already implemented some of the White Paper's recommendations,[29] although not those relevant to this mischief; we therefore express the hope that legislation in this regard will soon be forthcoming. For this reason we are not dealing with the question of insurance intermediaries in this working paper.

Scheme of the working paper

20. In Part II of this working paper we deal with the law relating to non-disclosure and the so-called "basis of the contract" clause. In Part III we deal with the law relating to warranties. In each case we outline the present law, set out various criticisms of it and consider ways in which the law might be reformed, including our provisional

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26 See their Fifth Report (1957) Cmnd. 62, para. 7; indeed, in para. 14(3) the Committee formulated a provision which in their view could be introduced into English law without difficulty under which any person who solicits or negotiates a contract of insurance should be deemed, for the purposes of the formation of the contract, to be the agent of the insurers, and that the knowledge of such person should be imputed to the insurers.

27 Insurance Intermediaries (1977) Cmnd. 6715.

28 Ibid., at paras. 10-12, and 14-17.

29 Those relating to the internal organisation of, and the ethical and professional standards of insurance brokers: see the Insurance Brokers (Registration) Act 1977 and regulations made thereunder.

proposals for reform. In Part IV we describe and analyse the alternative approach to reform provided by Articles 2, 3 and 4 of the draft directive. In Part V we consider two miscellaneous matters[30] in respect of which no provisional proposals for reform are made. Part VI contains our general comments on the topics dealt with in this working paper. Appendix A reproduces the texts of the Statement of Insurance Practice and the Statement of Long-Term Insurance Practice respectively. In Appendix B Articles 2, 3 and 4 of the draft directive are reproduced. In Appendix C the law relating to non-disclosure and warranties in other common law and some civil law jurisdictions is summarised.

30 Including contracts of re-insurance.

PART II - THE DUTY OF DISCLOSURE

A. The present law: its development and rationale

General

21. In the English law of contract the general rule is that a contracting party is under no duty to disclose material facts known to him but not to the other party: there is no duty of good faith on the parties when they enter into a contract.[31]

22. To this general rule there is an exception in respect of contracts uberrimae fidei, that is to say contracts of the utmost good faith. The most important contract uberrimae fidei is the contract of insurance:

> "It has been for centuries in England the law in connection with insurance of all sorts, marine, fire, life, guarantee and every kind of policy that, as the underwriter knows nothing and the man who comes to him to insure knows everything, it is the duty of the assured... to make a full disclosure to the underwriters without being asked of all the material circumstances."[32]

Extent of the duty

23. The Marine Insurance Act 1906 codified the common law in relation to marine insurance, although its provisions probably reflected the common law rules applicable at that time to all classes of insurance. Section 18 of the Act provides:

> "(1) ... the assured must disclose to the insurer, before the contract is concluded, every material circumstance which is known to

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31 Keates v. Cadogan (1851) 10 C.B. 591; 138 E.R. 234; Fletcher v. Krell (1873) 42 L.J. Q.B. 55.

32 Rozanes v. Bowen (1928) 32 Ll.L.R. 98, 102.

the assured, and the assured is deemed to know every circumstance which, in the ordinary course of business, ought to be known by him. If the assured fails to make such disclosure, the insurer may avoid the contract.

(2) Every circumstance is material which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk."

24. In Lambert v. Co-operative Insurance Society Ltd.,[33] the Court of Appeal considered the duty of disclosure in non-marine insurance and held reluctantly[34] that:

(a) there was no obvious reason why there should be a rule of disclosure in marine insurance different from the rules in other forms of insurance;

(b) the statement by the Law Reform Committee[35] in their Fifth Report that for the purpose of any contract of insurance no fact should be deemed material unless it would have been considered material by a reasonable insured, was a recommendation to change the law and not an existing rule; and

(c) a fact was material if it would influence the mind of a prudent insurer.

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33 [1975] 2 Lloyd's Rep. 485.

34 Their Lordships' criticisms of the present law are referred to in para. 37, below.

35 (1957) Cmnd. 62.

We should point out that in the Lambert case the Court of Appeal were considering the insured's duty of disclosure upon renewal of a policy and treated the renewal as the making of a fresh contract on the basis that the contract of insurance in question fell to be renewed year by year.

Consequences of non-disclosure by the insured

25. If the insured has failed to comply with his duty of disclosure, the insurer has, on notice of the failure or within a reasonable time thereafter, the right to repudiate the contract of insurance. Upon the exercise of that right the contract is avoided ab initio, but it remains in force until so avoided.[36] The result is that if the insurer has already paid a claim he is entitled to demand repayment of the sum so paid; similarly the insured is entitled, in the absence of fraud, to demand the repayment of such premiums as he may have paid.[37]

Justification of the doctrine

26. The formulation of the rule in Lambert v. Co-operative Insurance Society Ltd. is very little different from its formulation by Lord Mansfield in 1766, who justified it as follows in Carter v. Boehm:[38]

> "Insurance is a contract upon speculation. The special facts, upon which the contingent chance is to be computed, lie most commonly in the knowledge of the insured only: the under-writer trusts to his representation, and proceeds upon

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36 MacGillivray & Parkington on Insurance Law (6th ed., 1975) chap. 10, paras. 745-746.

37 Cornhill Ins. Co. v. Assenheim (1937) 58 Ll.L.R. 27, 31.

38 (1766) 3 Burr. 1905, 1909; 97 E.R. 1162, 1164.

> confidence that he does not keep back any circumstance in his knowledge, to mislead the under-writer into a belief that the circumstance does not exist, and to induce him to estimate the risque as if it did not exist."

27. Over 100 years later, the Court of Appeal in Seaton v. Burnand[39] reiterated the substance of this justification of the doctrine and emphasised that it would be inequitable for the insured to demand a competitive premium while he has the "means of knowledge as to the risk, and the insurer has not the means or not the same means."[40] Putting it shortly, the insured knows a great deal about the risk, but the insurer may not be able to assess it at all, except perhaps statistically.

Application of the doctrine

28. How have the courts applied the doctrine? If the insured knows facts which indicate that the subject-matter of the insurance is exposed to abnormal physical danger from the perils insured against, he has to disclose them to the insurer. Any fact suggesting that the life assured will be shorter than expected by the insurer ought to be disclosed. For instance, it should be disclosed that after the applicant has been medically examined, he has become emaciated and troubled with a cough, and has consulted a doctor.[41] The situation or user of a building will be material if these suggest that the subject-matter of the insurance is particularly vulnerable to risk of damage by fire: for instance, it should be disclosed when applying for insurance on a warehouse that there has been a fire the same evening in the premises next but one to the warehouse.[42]

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39 [1899] 1 Q.B. 782.

40 Ibid., at 793.

41 Morrison v. Muspratt (1827) 4 Bing. 60; 130 E.R. 690.

42 Bufe v. Turner (1815) 6 Taunt. 338; 128 E.R. 1065.

If goods are insured against theft any fact suggesting that they are exposed to an unusual risk of loss by theft is material. Any previous losses are relevant to the risk of further losses because a prudent insurer would wish to investigate them in order to see to what extent the insured's carelessness may have contributed to them.[43] An applicant for motor insurance ought to make full disclosure of any accidents in which he has been involved and this disclosure should extend to the accident record of any driver who to his knowledge is going to drive the car.[44] Difficult problems arise in regard to the integrity of the insured and "moral hazard". The insured's conviction for a robbery some twelve and a half years earlier was held to be a material fact which he ought to have disclosed when completing his application form for an advance of money from a building society; the form stated that the society would insure the house against fire but the insured was not asked for any information for the purposes of the insurance other than the amount for which the cover was to be granted.[45] When cover had been granted under a jeweller's block policy and the insured had been robbed of diamonds, it was held that the insured should have disclosed that its sales manager had been convicted some years previously in the United States for smuggling diamonds and jewellery into the United States.[46] Sometimes there is a duty of disclosure when the insured has experienced refusals to insure or to renew previous policies, even in respect of other risks.[47] The excessive

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43 Becker v. Marshall (1922) 11 Ll.L.R. 114.

44 Dent v. Blackmore (1927) 29 Ll.L.R. 9; Dunn v. Ocean, Accident and Guarantee Corpn. Ltd. (1933) 47 Ll.L.R. 129.

45 Woolcott v. Sun Alliance and London Insurance Ltd. [1978] 1 W.L.R. 493; but see now the Rehabilitation of Offenders Act 1974, s. 4(3)(a).

46 Roselodge v. Castle [1966] 2 Lloyd's Rep. 113.

47 Locker & Woolf Ltd. v. Western Australian Insurance Co. Ltd. [1936] 1 K.B. 408.

over-valuation of the subject-matter of the insurance for the purpose of a valued policy is a material fact which ought to be disclosed.[48]

The doctrine today

29. These examples show how the doctrine has been applied during the two centuries since Carter v. Boehm. In the mid-18th century the most important type of insurance was marine cover, and vessels' owners were far more likely than the insurer to know or to have available information about the hazards of a particular voyage. Insurers did not have the means of communication available to enable them to make enquiries. The doctrine was a product of these circumstances. Today, in addition to their use of statistical methods for assessing risks, insurers have the opportunity to arrange for the inspection of property by surveyors or other experts, to arrange medical examinations, and have extensive facilities for making enquiries. Perhaps even more important is the practice of requiring the insured to answer a long list of detailed questions concerning the risk. The completion of a proposal form by the insured may affect his duty of disclosure and it is therefore necessary for us to consider, the present law as to non-disclosure where there is a proposal form.

The duty where there is a proposal form - general

30. The modern proposal form usually includes a printed questionnaire which the proposer is required to complete. The questions may relate to facts existing at the time of the proposal or which existed at some time in the past. Alternatively, or in addition, they may refer to the future.[49]

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48 Ionides v. Pender (1874) L.R. 9 Q.B. 531.

49 As such they will usually amount to promises by the insured that he will do or refrain from doing something or that a fact or state of affairs will continue to be true. They will be contractually binding if incorporated as a term of the contract of insurance or if construed as a collateral warranty: see para. 88, below.

When the proposer is answering questions as to past or present facts (but not as to the future), the duty of good faith requires that, to the extent that these relate to material facts, his answers should be accurate in the sense that they do not mislead.[50] If an inaccurate answer is given as to a material fact the insurer is entitled to avoid the policy ab initio and reject any claim that has arisen.[51] The meaning of materiality in this context is the same as in the context of non-disclosure where there is no proposal form, which has been discussed by us earlier.[52] Although we are concerned with non-disclosure at this stage, it should be borne in mind that an answer to a question in a proposal form may well be actionable as a positive misrepresentation of fact.[53]

Statements of fact and statements of opinion

31. In order to ground a repudiation of the policy, an inaccurate statement must be one of fact and not one of opinion or of law. Statements of opinion which turn out not to be well-founded are not actionable if the opinion was given in good faith.[54] Indeed, the courts have held that there are certain matters as to which the insurers cannot reasonably expect anything more than an expression of the insured's opinion; examples are questions of valuation[55] or statements as to good health.[56] As a general rule, however, an unqualified "no"

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50 Everett v. Desborough (1829) 5 Bing 503; 130 E.R. 1155.

51 Graham v. Western Australian Insurance Co. Ltd. (1931) 40 Ll.L.R. 64, 66; Merchants' and Manufacturers' Insurance Co. v. Hunt and Thorne [1941] 1 K.B. 295.

52 See paras. 23-24, above.

53 We deal with the relationship between the law of misrepresentation and the provisional recommendations in this working paper at para. 169, below.

54 Anderson v. Pacific Fire and Marine (1872) L.R. 7 C.P. 65, 69.

55 Franklin Fire v. Vaughan (1875) 92 U.S. 516.

56 Joel v. Law Union and Crown [1908] 2 K.B. 863.

to a question in a proposal form will be construed as relating to the facts themselves and not to the proposer's knowledge or opinion of them.[57]

Waiver of disclosure

32. The general rule is that the mere fact that an insured has answered questions in a proposal form does not relieve him of his general duty of disclosure.[58] There may however be circumstances in which the courts can infer a waiver by the insurer of further disclosure. For instance, where specific and detailed questions have been asked, as in a proposal form, the insurer may be precluded from contending that matters not mentioned in the proposal form are material.[59]

Ambiguous questions

33. Where a question is ambiguous the overriding principle is that a fair and reasonable construction must be placed upon it.[60] Accordingly, if an ambiguous question is put to an applicant in a proposal form, the insurers cannot rely on the inaccuracy of the answer as a ground for repudiating the policy if that answer is true having regard to the construction which a reasonable man might put upon the question and which the applicant did in fact put upon it.

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57 Zurich General Accident and Liability Insurance Co. v. Leven 1940 S.C. 406.

58 Glicksman v. Lancashire & General Assurance Co. Ltd. [1927] A.C. 139; see also Schoolman v. Hall [1951] 1 Lloyd's Rep. 139, 142 per Cohen L.J.

59 See McCormick v. National Motor Accident Insurance Union Ltd. (1934) 49 Ll.L.R. 361, 363 per Scrutton L.J. and Schoolman v. Hall [1951] 1 Lloyd's Rep. 139, 143 per Asquith L.J. See para. 71, below for a discussion of what constitutes a proposal form.

60 Condogianis v. Guardian Assurance Co. [1921] 2 A.C. 125, 130 per Lord Shaw of Dunfermline.

However, there is no presumption that the interpretation most favourable to the insured is necessarily that which is fair and reasonable.[61]

Duration of the duty of disclosure

34. For completeness, we should mention that the insured is subject to the duty of disclosure until a binding contract has been concluded with the insurer.[62] He must therefore correct any answer given in a proposal form if, although it was accurate at the time it was given, a supervening event has rendered it inaccurate or misleading.[63]

B. Criticisms of the present law as to non-disclosure

35. The application of the present law as to non-disclosure in modern conditions has given rise to much criticism. We set out some of these criticisms in the following paragraphs.

The Fifth Report of the Law Reform Committee[64]

36. In their Fifth Report the Law Reform Committee said:

> "(4) ... it seems to us to follow from the accepted definition of materiality that a fact may be material to insurers ... which would not necessarily appear to a proposer for insurance, however honest and careful, to be one which he ought to disclose."

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61 Holt's Motors v. S.E. Lancashire Ins. Co. (1930) 37 Ll. L.R. 1, 4 per Scrutton L.J.

62 Lishman v. Northern Maritime Insurance Co. (1875) L.R. 10 C.P. 179, 182; Re Yager and Guardian Assurance Co. (1913) 108 L.T. 38; the Marine Insurance Act 1906, s.18(1); see paras. 23-24, above.

63 See Looker v. Law Union and Rock Insurance Co. Ltd. [1928] 1 K.B. 554-559.

64 (1957) Cmnd. 62.

Lambert v. Co-operative Insurance Society Ltd.[65]

37. Prior to the Lambert case there was some doubt as to which was the correct test for the materiality of a non-disclosed fact. There was a line of authorities[66] which suggested that in at least certain classes of insurance the law was not as stated by the Law Reform Committee[67] but was that the insured was under a duty to disclose only such facts as a reasonable man would believe to be material. This doubt was, as we have seen,[68] removed by the Lambert case. All three judges in the Court of Appeal were however critical of the existing law. MacKenna J., who delivered the leading judgment, said:

> "I would only add to this long judgment the expression of my personal regret that the Committee's recommendation has not been implemented. The present case shows the unsatisfactory state of the law. Mrs. Lambert is unlikely to have thought that it was necessary to disclose the distressing fact of her husband's recent conviction when she was renewing the policy on her little store of jewellery. She is not an underwriter and has presumably no experience in these matters. The defendant company would act decently if, having established the point of principle, they were to pay her. It might be thought a heartless thing if they did not, but that is their business, not mine. I would dismiss the appeal."[69]

Lawton L.J. said:

> "The explanation for this desire to show that the test[70] accepted by the Privy Council in 1925[71] in the clearest possible

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65 [1975] 2 Lloyd's Rep. 485.

66 See Joel v. Law Union and Crown [1908] 2 K.B. 863, 884-885 and Roselodge v. Castle [1966] 2 Lloyd's Rep. 113.

67 Namely that a fact was material if it would influence the judgment of a prudent insurer in fixing the premium or in taking the risk: see paras. 23-24, above.

68 See para. 24, above.

69 [1975] 2 Lloyd's Rep. 485, 491.

70 The "prudent insurer" test cited in n. 67, above.

71 In Mutual Life Assurance Co. of New York v. Ontario Metal Products Co. Ltd. [1925] A.C. 344.

> terms is not the true test may be because some lawyers are of the opinion that it is unfair to many policy holders. It was said by Mr. Lewis, with some force, that when the law first began to develop in the 18th century those who sought to get the benefit of insurance cover were really acting with the same sort of knowledge and understanding as the underwriters from whom they were seeking cover. Nowadays when the ordinary citizen seeks to take out insurance cover for his house and belongings he is not acting on equal terms with the insurance companies. Much as I sympathize with the point of view which was put forward by Mr. Lewis, I cannot accept that it can alter the law."[72]

His Lordship went on to observe:

> "Such injustices as there are must now be dealt with by Parliament, if they are to be got rid of at all."[73]

Cairns L.J. said:

> "I share with respect the view that was expressed in [the Law Reform Committee's] report that the law might well be changed..."[74]

Other criticisms

38. It has been pointed out[75] that many laymen are not aware that a duty of disclosure exists and that it may be very difficult if not impossible for those who are aware of the duty to know what information would be regarded as material by a prudent insurer. One writer has observed that the duty imposes an especially heavy burden on insureds who

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72 [1975] 2 Lloyd's Rep. 485, 492.

73 Ibid., at 492.

74 Ibid., at 493.

75 R.A. Hasson "The doctrine of uberrima fides in insurance law - a critical evaluation" (1969) 32 M.L.R. 615, 633.

hold a policy which is renewable year by year as they are most unlikely to realise that the duty arises on each successive renewal.[76] Another has raised the problem of the extent of the duty on an insured when he applies over the telephone for the issue of a cover-note by an insurer.[77]

39. The general rule of the present law whereby an insured is not relieved of his duty of disclosure even where the insurer has asked questions of him in a proposal form,[78] has been criticised[79] on the ground that the insured may well have been led to suppose that no further information was required to be disclosed by him.

40. In endeavouring to ascertain the materiality of particular facts, the courts will hear the expert evidence of other insurers; such evidence will be produced by the insurer who will select its expert witnesses. Some judicial doubt has been cast on the cogency of such evidence.[80] For instance, it has been thought odd[81] that an insurer who would not himself have regarded a non-disclosed fact as material should be able to call evidence that a prudent insurer would have done so.

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76 R. Merkin "Uberrimae fidei strikes again" (1976) 39 M.L.R. 478, 480; see para. 24, above.

77 J. Birds "What is a cover-note worth?" (1977) 40 M.L.R. 79.

78 See, however, para. 32, above.

79 See, for instance, J. Birds "The Statement of Insurance Practice - a measure of regulation of the insurance contract" (1977) 40 M.L.R. 677, 680.

80 Roselodge v. Castle [1966] 2 Lloyd's Rep. 113, 131 per McNair J. See also Reynolds v. Phoenix Assurance Co. Ltd. [1978] 2 Lloyd's Rep. 440, 457-459 per Forbes J.

81 See Berger v. Pollock [1973] 2 Lloyd's Rep. 442, 463 per Kerr J.

41. Criticism[82] has also been directed to judicial decisions as to the materiality of particular types of fact. It will suffice to mention two such decisions. One is Regina Fur v. Bossom[83] in which an insurer was held entitled to repudiate on the grounds of the insured's failure to disclose a conviction that had taken place 23 years earlier. Another is Locker & Woolf Ltd. v. Western Australian Insurance Co.[84] in which the non-disclosed fact held to be material was a previous rejection with regard to an entirely different type of insurance from that which was being applied for.

42. We are impressed by these criticisms and have reached the conclusion that the law as to non-disclosure should be reformed.

C. Reform of the present law - the field of choice

43. Having described the present law of non-disclosure, and set out some of the criticisms it has attracted, we shall consider three possible ways in which it can be reformed:

(i) the abolition of any duty to disclose;[85]

(ii) the retention of the existing duty but the modification of the "all or nothing" nature of the present law by the adoption of the so-called "proportionality principle";[86]

(iii) the retention of the duty but the alteration of its ambit.[87]

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82 See R.A. Hasson "The doctrine of uberrima fides in insurance law - a critical evaluation" (1969) 32 M.L.R. 615, 622-623, 626.

83 [1957] 2 Lloyd's Rep. 466; but now see Rehabilitation of Offenders Act 1974, s.4(3)(a) and cf. Reynolds v. Phoenix Assurance Co. Ltd. [1978] 2 Lloyd's Rep. 440, 459-461 per Forbes J.

84 [1936] 1 K.B. 408.

85 See paras. 44-51, below.

86 See paras. 52-57, below.

87 See paras. 58-96, below.

We shall examine each of these approaches and reach a provisional conclusion as to which of them is to be preferred.

(i) The abolition of any duty to disclose

44. The first approach to be considered is the abolition of any duty to disclose. The argument which can be advanced in favour of this proposal is that the circumstances prevailing at the time of Lord Mansfield's judgment in Carter v. Boehm[88] have altered so substantially that the rationale for the duty is no longer valid. These circumstances were that the main type of cover was marine and that the shipowner or charterer had the only means of knowing the facts relevant to the risk. As the insured possessed the means of knowing these facts and the insurer did not, and as the insurer needed to have this information in order to decide whether to accept the risk and what premium to charge, the insurer could not conduct his business unless the insured made full disclosure of all the relevant information that was known to him. Today insurers underwrite many and varied types of cover and enter into contracts of insurance with the householder, the car-owner and many others. The insurer generally has the opportunity to ascertain most of the facts relevant to the risk and he avails himself of numerous techniques for eliciting these facts.[89]

The use of the proposal form

45. As we have seen,[90] one of the most important of these techniques is the asking of detailed questions of the insured in a proposal form. Where the insured has answered detailed questions he may well assume that he is under no duty to supply further information; after all, the insured generally knows from experience what information he needs. These considerations

88 (1766) 3 Burr. 1905; 97 E.R. 1162.

89 See para. 29, above for a description of some of these techniques.

90 See para. 29, above.

on their own would suggest that if the insurer wishes to have information to enable him to assess the risk he must ask the insured for it and that the insured should be relieved of any duty to disclose material information except in answer to questions posed by the insurer.

46. However, there are further considerations. One is that the contract of insurance still remains, despite the change in circumstances since Lord Mansfield's day, a contract of speculation, the parties to which remain in a very unequal position with regard to the actual possession of knowledge relevant to the risk. Another is that in relation to very many commercial risks it is the practice of the industry not to make use of proposal forms but to rely at least in part on the insured's duty of disclosure as well as on underwriters' own means of information and enquiry.

Provisional cover

47. Very often provisional insurance cover is granted prior to the completion of a proposal form. For example, insurance cover for motor vehicles is usually granted over the telephone by a broker and a cover-note is then issued. Similarly house insurance cover is often granted over the telephone to a person who has just exchanged contracts for the purchase of a property. We are not satisfied that it would be either convenient or practicable from the commercial point of view to compel an insurer or a broker in a telephone conversation relating to provisional cover to elicit by question and answer all the facts material to the risk. It is likely that such a procedure would lead to disputes as to what questions had been asked and what answers had been given and consequently to litigation. Moreover in the absence of any duty it would be open to the insured to conceal information which he knew to be material but which was unusual in its

nature, so that the insurer or the broker could not reasonably be expected to ask about it over the telephone.[91]

Cover where no proposal form is ever issued

48. There are, in addition to large commercial risks, other types of cover in respect of which no proposal form is ever issued. In such cases the question may arise whether or not the insurer has waived his right to disclosure of material facts additional to those which have been furnished to him. An example of where there will almost certainly have been such a waiver is the purchase by intending passengers of "coupon insurance" at airport counters to cover the risk of injury and death whilst in flight; the purchaser is usually required to complete an application form which merely asks for his age, name and address and the destination of the flight.[92]

The results of abolition

49. The abolition of any duty would compel the use of proposal forms in relation to the commercial risks to which we have referred; we consider that this would be neither desirable nor practicable from the commercial point of view. With regard to the other types of cover granted without a proposal form to which we have referred, the abolition of the duty would almost certainly lead to higher premiums to compensate for "sharp practice" on the part of the few. This result would be not only economically wasteful but also unjust to other policy holders. Although it would almost certainly not lead insurers to withdraw facilities for immediate cover (in relation to, for example, motor vehicle, house and travel insurance), it might well lead them in addition to charging higher premiums to insert into their policies a greater number of conditions and exceptions to narrow the scope of the risk.

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91 This consideration is also relevant, though to a lesser extent, in relation to what the insured's duty of disclosure should be where a proposal form has been completed by him and we deal with this matter at paras. 65-77, below.

92 See para. 71, below for a discussion of what constitutes a proposal form.

Abolition of the duty with respect to consumers

50. An alternative to the abolition of the duty across the board would be its abolition with respect to a certain class of insureds who may need special protection. We have indicated that, since Lord Mansfield's day, the available types of insurance cover have expanded. Many of those now seeking cover are persons who are not acting in the course of a business but who are consumers. They are unlikely to realise that they are under a duty of disclosure or to know of its ambit and they may well not be advised by a broker.[93] However, we believe that the arguments in regard to "sharp practice" which we have advanced against the abolition of any duty of disclosure apply equally to any proposal that it be abolished in relation to consumers only.

Our provisional conclusion

51. Our provisional conclusion is therefore that a duty of disclosure should be retained across the board. It follows that there should be a duty of disclosure in all cases where cover is applied for irrespective of whether or not there is a proposal form, whether or not the cover applied for is provisional, and whether the cover is applied for orally or in writing. It is significant that some duty of disclosure is imposed on the insured not only by the draft directive[94] but also by the laws of all the common law and civil law jurisdictions that we have been able to study.[95] Comments are invited.

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93 Who will almost certainly owe them a duty of care in this connection: see Mallough v. Barber (1815) 4 Camp. 150; 171 E.R. 49; Park v. Hammond (1816) 6 Taunt. 495; 128 E.R. 1127; Chapman v. Walton (1833) 10 Bing. 57, 63; 131 E.R. 826, 829. For a recent case see McNealy v. Pennine Insurance Co. [1978] 2 Lloyd's Rep. 18.

94 Article 2(1); see paras. 130-133, below for an analysis and description of this provision.

95 See Appendix C paras. 1-3, 13-14, and 20-21 for the law relating to non-disclosure in some other common law and civil law jurisdictions.

(ii) The retention of the duty and the adoption of the proportionality principle

52. The second approach to be considered is the retention of the existing duty of disclosure but the modification of the remedies available to the insurer for breach of it by the insured. French law provides that if, after a claim has been made, the insurer discovers that the insured has failed to comply with his duty to disclose material circumstances, but is not able to prove mala fides, he is not entitled to refuse payment altogether but is obliged to pay that proportion of the claim which the actual premium paid bears to the premium which would have been payable if all material circumstances had been accurately disclosed.[96]

53. The attraction of the proportionality principle is that it eliminates the "all or nothing" nature of the present law which entitles the insurer to refuse payment of a claim altogether where there has been a failure to disclose a material fact.

54. In evaluating the proportionality principle it must be borne in mind that French insurance practice differs considerably from our own. There is in France a comprehensive system of fixed tariffs, supervised by administrative control, for premiums corresponding to the circumstances of the risks to be covered. As a matter of evidence, therefore, it would presumably be easy in many cases for a French court to ascertain what premium would have been charged had all material circumstances been disclosed. In England there is,

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96 Code des Assurances, Article 113-9; see Appendix C, para. 14; the draft directive has adopted a similar principle for improper non-disclosure: for a description and analysis of the relevant provision of the draft directive see para. 143, below.

by contrast, no comprehensive system of administratively controlled tariffs, although insurers do have their own tables of premiums in connection with life insurance and with motor insurance.[97]

55. There is a further difficulty: would the notional premium be what the particular insurer in question would have charged or what a prudent insurer would have charged?[98] If the former interpretation were to be adopted it would often be difficult in practice for the insured to challenge successfully the insurer's evidence as to the notional premium. In our view this could lead to abuse by insurers. If the latter interpretation were to be adopted, the court would require expert evidence to determine the notional premium. We have seen that the tendering of expert evidence regarding the materiality of non-disclosed facts has attracted judicial criticism[99] and such criticism would apply to a greater extent to the issue of the notional premium. The court would need to receive expert evidence, not only as to whether the judgment of the prudent insurer in accepting the risk and in fixing the premium would have been influenced, but also as to what such an insurer's computation of the hypothetical premium would have been. The insured's position might often be invidious, because insurers would obviously be in a far better position than the insured to obtain expert evidence, irrespective of the party on whom the onus of proving the notional premium were placed.

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97 In England the only comprehensive tables of premiums which can be used virtually automatically are those for life cover which relate the amount of the premium to the age of an applicant in normal health. There are also detailed rates in motor insurance relating to, inter alia, the make of vehicle, the area in which it is used and the age and occupation of the owner; however, the fixing of the actual premiums is a much more complicated process because different cover may be obtainable from different insurers for different risks at different premiums.

98 The draft directive appears to resolve the ambiguity in favour of the former interpretation: see Articles 2(1) and 2(3)(c).

99 See para. 40, above.

56. Another consideration is that the proportionality principle is based on the assumption that, had the increased risk been disclosed, a contract would have been entered into between the insured and the insurer at the notional higher premium. However, this assumption itself rests on two premisses. First, that the insurer would have been willing to cover the increased risk at some premium; secondly, that the insured would have been willing to pay the notional higher premium for the cover. Both these premisses may well be false in a substantial number of cases. Many insurers, having regard to the quality of the risks usually accepted by them in the course of their business, might not have been willing to underwrite the increased risk at any premium. Should they be permitted to put this defence forward as a complete answer to a claim? French law[100] does not appear to allow this defence, at least in relation to non-marine insurance.[101] If such a defence were to be allowed, the difficulties inherent in applying the proportionality principle in practice, to which we referred in paragraph 55, would be exacerbated. However, in our view the proportionality principle without this defence would be untenable and would, we think, be totally unacceptable to the insurance industry in this country. As for the second premiss upon which the assumption is based, the insured might have preferred to carry the risk himself rather than to pay the notional higher premium for the increased risk.

57. Our provisional conclusion is that the proportionality principle would not be a desirable innovation in this country. Comments are invited.

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100 Code des Assurances, Art. 113-9; for the marine insurance rule see Code des Assurances Art. L.172-2.

101 Articles 2(6) and 3(8) of the draft directive do allow this defence but their inclusion in the draft directive is provisional only and their survival in future drafts is by no means certain: see paras. 145 and 154, below.

(iii) The retention of a duty of disclosure and the alteration of its ambit

58. If the insured is to continue to be subject to a duty of disclosure and the remedies for its breach are to remain unchanged, the question arises whether the extent of that duty should be altered. We have seen that the existing ambit of the duty has been widely criticised[102] and that the Law Reform Committee in their Fifth Report[103] formulated a modified duty under which the insured would be required only to disclose such facts as would appear to a reasonable insured to be material.[104] If this formulation were adopted many of the criticisms of the duty, both judicial[105] and extra-judicial,[106] would be met. There is therefore a strong case for retaining the duty but altering its scope in a manner similar to that suggested by the Law Reform Committee's formulation. The Committee's formulation was brief and we shall endeavour, in the following paragraphs, using their formulation as a basis, to set out a more detailed proposal for reform of the law. Our recommendations will be elaborated under four headings:-

(a) The duty of disclosure where there is no proposal form;

(b) The duty of disclosure where there is a proposal form;

(c) "Basis of the contract" clauses;

(d) Renewal.

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102 See paras. 37-38, above.

103 (1957) Cmnd. 62.

104 Ibid., at para. 14(1).

105 See, in particular, dicta in Lambert v. Co-operative Insurance Society Ltd. [1975] 2 Lloyd's Rep. 485 at 491, 492 and 493: see para. 37, above.

106 See paras. 38-41, above.

(a) The duty of disclosure where there is no proposal form

59. Where there is no proposal form we consider that the insured should remain under the modified duty to disclose material facts described in the following paragraphs. This would be the position where he obtains cover before a proposal form has been completed and where cover is obtained without a proposal form ever being completed.

The extent of the duty

60. In our view the insured's duty of disclosure where there is no proposal form should be to disclose those facts which a reasonable man in his circumstances would consider to be material in the sense that they would influence the judgment of a prudent insurer in accepting the risk or fixing the premium. The insured should however only be under a duty to disclose facts which he either knows or which a reasonable man in his circumstances ought to know. This formulation is similar to that of the Law Reform Committee. Two features of this proposal require elaboration.

(1) "A reasonable man in his circumstances"

61. This formulation departs slightly from that of the Law Reform Committee which refers to "a reasonable insured". The Law Reform Committee's wording suggests that the particular insured should be judged solely by the objective standard of a reasonable insured, that is to say without taking the particular circumstances of the particular insured into account. We are concerned that this test may be too inflexible; thus it may be suitable for businessmen but it may be too exacting for the individual seeking, say, motor or household insurance as a consumer. Under our recommendations the court should therefore be enabled to take the individual's circumstances into account. Accordingly, the standard of disclosure required would depend on, inter alia, whether the insured was a businessman or a consumer.

Such a formulation would go some way to meeting the argument considered above[107] that any duty of disclosure might be inappropriate for consumers.

However, we have not reached a firm view as to precisely what circumstances the court should be entitled to take into account, and we consider it likely that in any legislation guidelines might be required. Comments are invited.

62. Another advantage of this test is that the need for expert evidence as to what facts would have influenced the judgment of a prudent insurer, with its attendant expense and unfairness to the insured,[108] would fall away. The courts would simply apply the standards of a reasonable man in the circumstances of the insured in order to decide whether there had been a breach of the duty. Judges have of course great experience in applying such standards and a body of case-law would soon build up.

(2) "Which he knows or which a reasonable man in his circumstances ought to know

63. "The duty is a duty to disclose, and you cannot disclose what you do not know. The obligation to disclose, therefore, necessarily depends upon the knowledge you possess."[109] Does the duty in the present law extend to facts which are within the insured's constructive, although not actual, knowledge? The rule in marine insurance is that the insured will be treated as knowing facts if in the ordinary course of business he ought to have known them.[110]

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107 At para. 50, above.

108 See para. 40, above.

109 Joel v. Law Union and Crown [1908] 2 K.B. 863, 884 per Fletcher Moulton L.J.

110 The Marine Insurance Act 1906, s.18(1): see para. 23, above.

It has never been clearly established whether the marine insurance rule applies equally to non-marine insurance, and certainly the words "in the ordinary course of business" seem inapt to cover individuals obtaining cover other than in the course of business. The present law is therefore uncertain.

64. The question of policy is whether an insured, be he consumer or businessman, should be entitled to plead ignorance of a fact which he does not know but which he ought to know. Under our proposals this question is resolved by attributing to the insured not only knowledge of the facts which he does know but also knowledge of the facts which a reasonable man in his circumstances ought to know. The advantage of this test is similar to that of our test for whether there has been a breach of duty; by taking the particular circumstances of the particular insured into account the court would be enabled to determine the scope of constructive knowledge to be attributed to him by reference to whether, inter alia, he is a consumer or a businessman. This flexibility ensures that injustice is unlikely to result from the application of the test by the courts.

(b) The duty of disclosure where there is a proposal form

The use of proposal forms

65. Insurers have three main techniques for obtaining information enabling them to assess the risk. They may rely on the insured's duty to disclose material facts. However, in practice insurers do not often rely merely on the insured's duty to volunteer information for this purpose, despite the high standard of disclosure required by the present law. They may therefore also carry out their own investigations into the nature of the risk, or cause such investigations to be made on their behalf. An example is the medical examination of a life proposed to be insured. Lastly, and most importantly, they may ask the insured questions about himself and about the risk. This is usually done by requiring the insured to complete and sign a proposal form. In the following

paragraphs we shall refer to various areas of difficulty in the present law and put forward our provisional recommendations for reform.

The extent of the duty

66. As we have pointed out,[111] insurers generally know from experience what questions they need to ask in order to obtain information enabling them to assess the risk and the insured is likely to assume that having answered these questions, no further information is required to be disclosed by him. Nevertheless, the general rule of the present law is that in these circumstances the insured is not relieved of his duty of disclosure.[112] Our view is that this state of affairs is unsatisfactory. Our provisional recommendation is that if a proposal form has been completed by the insured, insurers should not be permitted to say that a fact outside the scope of the questions asked is material and ought therefore to have been disclosed. Insurers should be taken to have waived the duty of disclosure in regard to that fact. In other words, if an insured has completed a proposal form he should be relieved of any further duty of disclosure, subject to a residual duty discussed below,[113] not deliberately to conceal known material facts.

The nature of the duty

67. Earlier[114] we reached the provisional conclusion that good faith on the part of the insured should remain a cornerstone of our law of insurance and accordingly that the insured's duty of disclosure should be retained. It follows that where there is a proposal form the insured should in our view prima facie only be considered to have discharged his duty of disclosure if he supplies complete and accurate answers to the material questions asked. Conversely, we

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111 See para. 45, above.

112 Although a waiver of the materiality of facts as to which no questions have been asked may sometimes be inferred: see para. 32, above.

113 See para. 73, below.

114 See paras. 44-51, above.

consider that if he fails to supply complete and accurate answers to the material questions in the proposal form he should prima facie be considered as being in breach of his duty of disclosure, with the result that the insurer will be entitled to repudiate the policy and reject any claim. We think that the insured should be made aware of the serious consequences for him of any failure to comply with the duty of disclosure: our provisional recommendation is therefore that the proposal form should carry a notice to the insured explaining to him his duty of disclosure and warning him of the consequences of any failure to comply with it.

Presumption of materiality of questions in a proposal form

68. The questions asked by insurers on a proposal form will generally concern facts which are material to the risk in the sense that the answers would influence the judgment of the prudent insurer as to whether to accept the risk and if so at what premium. In order to give effect to this general proposition we provisionally recommend that there should be a presumption that questions in proposal forms and the answers to them are material, with the consequences concerning the insured's duty of disclosure to which we referred in the previous paragraph. However, this should in our view only be a presumption, since proposal forms also sometimes include questions whose materiality is by no means self evident. We accordingly recommend that the insured should be able to rebut this presumption by proving that the question related to a fact or facts which would not have influenced the judgment of a prudent insurer in accepting the risk or fixing the premium.[115]

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115 Or that the disclosure of the fact could not lawfully have been required by the insurers: see the Rehabilitation of Offenders Act 1974, s.4(3)(a) and Reynolds v. Phoenix Assurance Co. Ltd. [1978] 2 Lloyd's Rep. 22 (C.A.); see also Reynolds v. Phoenix Assurance Co. Ltd. [1978] 2 Lloyd's Rep. 440, 461-462 per Forbes J.; or that the fact required to be disclosed could not lawfully have been taken into account by the insurers: see the Sex Discrimination Act 1975, s.29 and the Race Relations Act 1976, s.20.

Type of answer required from the insured

69. We have seen[116] that under the present law the courts sometimes construe certain questions which are apparently factual as asking for the insured's opinion only. This construction is usually adopted if the subject-matter of the question is a fact which the insured cannot reasonably be expected either to know or to have the means of knowing. An example would be the question on a proposal form for life insurance: "Have you any disease?"[117] Such a question is clearly not capable of being answered with factual accuracy.

70. We do not intend that an insured should be obliged to give an objectively accurate answer to every question on a proposal form and that the insurer should have the right to repudiate the policy and to reject any claim for an answer which, although true to the best of the insured's knowledge and belief, is in fact inaccurate. We believe that such a result would be unduly onerous on the insured. Our provisional recommendation is therefore that if the insured can prove that he has answered a material question in a proposal form to the best of his knowledge and belief, having carried out all those enquiries which a reasonable man in his circumstances would have carried out, he should be considered to have discharged his duty of disclosure notwithstanding that the answer is in fact inaccurate.

Our provisional recommendation is formulated in terms of the insured's actual and constructive knowledge for the following reason. An insured ought not to be able to plead ignorance of a fact which he either knows or which is reasonably ascertainable by him. On the other hand, he ought not to be considered to be in breach of his duty of disclosure if he fails to disclose a fact which he does not know and which is not reasonably ascertainable by him.

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116 See para. 31, above.

117 This question was given as an example by Fletcher Moulton L.J. in Joel v. Law Union and Crown [1908] 2 K.B. 863 at 885.

What is a proposal form?

71. We have so far been using the term "proposal form" loosely to refer to a written document in which the insured is asked questions about himself and about the risk. It is however necessary, for the purpose of our recommendation as to the insured's duty of disclosure, to provide a more precise definition of a proposal form. In deciding whether a written document is a proposal form, the court should have regard to the document as a whole. In our view, the test should be whether the document is such as to lead a reasonable man to suppose that no further information is required to be disclosed by him. In order to apply this test, the court will look at the questions. If detailed questions are asked of the type usually asked by insurers for the purpose of deciding whether to accept the risk and what premium to charge and if they appear to be comprehensive, we would expect the court to hold that the document is a proposal form. The court would not be bound by any statement in the document by the insurer, such as a statement that "This document is not a proposal form" or that "The questions asked in this document are not intended to be comprehensive."

The application of this test would not of course preclude the court from deciding that there had been a waiver of further disclosure in all the circumstances of particular cases in which no proposal form had been completed.

Difficulties with our recommendations

72. There are two possible difficulties with the above scheme. One is that the insured would be able with impunity to mislead the insurer by deliberately concealing information which he knows to be material to the risk but which is sufficiently unusual in its nature not to be covered by any question in the proposal form. The other is that insurers would tend to ask a "general question" such as "Are there any facts which you, as a reasonable insured, consider would influence the judgment of a prudent insurer in accepting

the risk or in fixing the premium?" Such a question would, in effect, re-introduce the general duty of disclosure through the back-door, thereby frustrating the object of our proposals. We deal with these difficulties in the following paragraphs.

The residual duty of disclosure

73. We consider that the first difficulty can be met by imposing a residual duty on the insured not deliberately to conceal facts which he knows to be material and of which he has actual knowledge. For example, if a farmer has received a threat to burn down his outbuildings from a disgruntled ex-employee whom he had dismissed he should be under a duty to disclose this fact if he applies for fire insurance on the outbuildings even if the fact is outside the ambit of all the questions asked in the proposal form. In the event of a breach of this duty by the insured, the insurer should be entitled to repudiate the policy and reject any claim that has arisen. This would give a residual, but necessary, protection to the insurer. A corollary of imposing this residual duty on the insured is that an insurer should be required to give clear and prominent notice of this duty in the proposal form and to warn the insured of the consequences of breach.

"General questions"

74. With regard to the second difficulty, insurers should not be entitled to ask a question on the lines of the "general question" mentioned in paragraph 72. An insured should be entitled to ignore any such question and insurers should be deprived of any remedy in respect of false information supplied in answer to any such question. However, they should be entitled to ask specific questions on any topics which they regard as material, although we realise that proposal forms may as a consequence become longer. For instance, it is quite likely that insurers would in that event ask questions as to facts affecting "moral hazard" which have been held by the courts to be material. Although such questions may be regarded as an intrusion into an

insured's privacy, we consider that from his own point of view it would be less objectionable to be asked questions as to such facts than to have them raised later as the basis for a defence of non-disclosure when a claim is made.

Practical effects of our provisional recommendations

75. At first sight it might be thought that the result of our recommendations would be to lead insurers to make less use of proposal forms and to place greater reliance on the insured's duty of disclosure on the ground that they would otherwise run the risk of omitting important and material questions from the proposal form. However, it seems to us unlikely that this would happen. Before granting cover, insurers are primarily interested in obtaining the information that will enable them to decide whether to accept the risk and, if so, at what premium; they are not interested in relying on the insured to provide this information in order to lay the foundation for a possible future repudiation of the policy if he has failed to volunteer it. For this reason they use proposal forms in relation to many types of risk. In addition it is, and will we think continue to be, administratively convenient for them to do so. Indeed, proposal forms may become an even more attractive means of obtaining material information in the light of our earlier provisional recommendation[118] that the standard of disclosure required of the insured where there is no proposal form should become less stringent than under the present law.[119] Comments are invited.

Construction of ambiguous questions in the proposal form

76. There is one aspect of the present law which is arguably capable of producing injustice. It arises when an insured misunderstands a question in the proposal form and answers it correctly according to his understanding of it but incorrectly according to its ordinary and natural meaning.

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118 At para. 60, above.

119 See paras. 23-24, above.

We think that the possibility of such injustice arising would be reduced by an extension of the contra proferentem rule of construction to the wording of questions in a proposal form. This is a rule that a document prepared by an insurer should be construed strictly against him. Under the existing law[120] this rule only applies to the wording of a policy or other contractual document. In our view this consideration is equally applicable to questions in proposal forms. Accordingly we provisionally recommend that where a question might reasonably be understood in two senses, one favourable to the insurer and the other favourable to the insured, the court ought always to construe it in the latter sense. It will be seen that this constitutes a departure from the present law[121] under which the court must place a fair and reasonable interpretation on an ambiguous question, even if it is not that most favourable to the insured.

The insured's entitlement to a copy of the proposal form

77. For reasons which are mentioned later,[122] we provisionally recommend that the insured should be entitled to receive a copy of the completed proposal form within a reasonable time of its submission to insurers.

(c) "Basis of the contract" clauses

(1) The present law

78. Today an insured is almost invariably required to make and sign a declaration in the proposal form wherein he warrants the truth of his answers to the questions asked by insurers or agrees that they are to be the basis of the contract of insurance or that their truth is a condition precedent to the validity of the contract. Sometimes the

120 See para. 105, below.

121 As to which see para. 33, above.

122 See para. 118, below. This recommendation is also relevant to the topic of renewal: see para. 89, below.

proposer is required to make all three declarations, or variations of them. Alternatively the policy may incorporate the statements in the proposal form by reference or provide that if any statement in the proposal form is untrue, the policy will be void.[123] For the sake of convenience we shall refer to undertakings of the kind just described as "basis of the contract" clauses.

79. The use of "basis of the contract" clauses appears to have begun in the 19th century for the purpose of making it clear to proposers that the information required of them by the proposal form was regarded as very important by insurers.[124] However, insurers soon found that there was also an important legal advantage in using them: since the effect of a "basis of the contract" clause is to elevate all the statements by the insured in the proposal form into "warranties", insurers thereby avoided the necessity and difficulty of proving to the satisfaction of the court that an inaccurate answer in a proposal form related to a fact which was material to the risk.[125] This was pointed out in Thomson v. Weems:[126] "When the truth of a particular statement has been made the subject of warranty, no question can arise as to its materiality or immateriality to the risk, it being the very purpose of the warranty to exclude all

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123 See Everett v. Desborough (1829) 5 Bing. 503; 130 E.R. 1155 and Anderson v. Fitzgerald (1853) 4 H.L. Cas. 484; 10 E.R. 551 for examples.

124 See R.A. Hasson "The 'basis of the contract' clause in insurance law" (1971) 34 M.L.R. 29, 38.

125 See MacGillivray & Parkington on Insurance Law (6th ed., 1975) chap. 10, para. 829; see also paras. 99 and 115, below as to warranties.

126 (1884) 9 App. Cas. 671.

controversy upon that point".[127] In the event of any breach of such warranty the insurer is entitled to repudiate the policy with retrospective effect, so that he was never at risk under it; he may accordingly reject any claims even in respect of losses which occurred prior to his discovery of the breach. Even if the fact warranted was quite immaterial to the risk; even if the breach did not cause or contribute to the loss; and even if the statement in the proposal form was made honestly and carefully and was true to the best of the insured's knowledge and belief,[128] the insurer becomes entitled to invoke these drastic remedies.

(2) Criticisms of the present law

80. The conversion of answers to questions in a proposal form from mere representations to "warranties" by "basis of the contract" clauses has attracted a great deal of judicial criticism. In Joel v. Law Union and Crown Insurance Co.[129] Fletcher Moulton L.J. said:

> "Insurers are thus in the highly favourable position that they are entitled not only to bona fides on the part of the applicant, but also to full disclosure of all knowledge possessed by the applicant that is material to the risk. And in my opinion they would have been wise if they had contented themselves with this. Unfortunately the desire to make themselves doubly secure has made them depart widely from this position by requiring the assured to agree that the accuracy, as well as the bona fides, of his answer to various questions put to him by them or on their behalf shall be a condition of the validity of the policy ... I wish I could adequately warn the public against such practices on the part of the insurance offices."[130]

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127 Ibid., at 689 per Lord Watson.

128 See generally MacGillivray & Parkington on Insurance Law (6th ed., 1975) chap. 10, esp. paras. 635-638 and 814-912.

129 [1908] 2 K.B. 863.

130 Ibid., at 885.

In Mackay v. London General Insurance Co.[131] Swift J. said, when giving judgment for the insurer because of an incorrect, but immaterial, answer to a question where the policy contained a "basis of the contract" clause:

> "I think he [the insured] has been very badly treated - shockingly badly treated. They [the insurers] have taken his premium. They have not been in the least bit misled by the answers which he had made."[132]

In Glicksman v. Lancashire & General Assurance Co. Ltd.[133] Lord Wrenbury said, when giving judgment for the insurers in similar circumstances:

> "I think it a mean and contemptible policy on the part of an insurance company that it should take the premiums and then refuse to pay upon a ground which no one says was really material. Here, upon purely technical grounds, they, having in point of fact not been deceived in any material particular, avail themselves of what seems to me the contemptible defence that although they have taken the premiums, they are protected from paying."[134]

Such clauses have also been judicially described as being "traps"[135] for the insured and in one case[136] the court took the view that a strict construction of such a clause rendered the "policy [in which it was contained] ... not worth the paper upon which it was written"[137] and liable to

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131 (1935) 51 Ll.L.R. 201.

132 Ibid., at 202.

133 [1927] A.C. 139.

134 Ibid., at 144-145.

135 Zurich Insurance Co. v. Morrison [1942] 1 All E.R. 529, 537 per Lord Greene M.R.

136 Anderson v. Fitzgerald (1853) 4 H.L. Cas. 484; 10 E.R. 551.

137 Ibid., at (1853) 4 H.L. Cas. 484, 507; 10 E.R. 551, 560 per Lord St. Leonards.

produce a result whereby "no prudent man [would] effect a policy of insurance with any Company without having an attorney at his elbow to tell him what the true construction of the document is".[138]

81. Extra-judicial criticism of "basis of the contract" clauses has focussed on two features. The first is that they give insurers the right to repudiate for what would otherwise be non-fraudulent immaterial misrepresentations. The second is that they give insurers the right to repudiate for statements which, although true to the best of the insured's knowledge and belief, are in fact inaccurate;[139] this result has been considered particularly draconian in relation to proposal forms for life policies in which the insured is asked questions about the state of his health.[140]

82. We agree with these criticisms.[141]

(3) Reform of the present law

The mischief

83. It is clear from the foregoing criticisms that "basis of the contract" clauses constitute a major mischief in the present law. These clauses, to the extent that they apply to statements of past and present fact in a proposal form, seem to us to be objectionable on three main grounds. First, they enable insurers to repudiate the policy for an inaccurate statement as to such a fact even though it is not

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138 Anderson v. Fitzgerald (1853) 4 H.L. Cas. 484, 514; 10 E.R. 551, 563 per Lord St. Leonards.

139 See R.A. Hasson "The 'basis of the contract clause' in insurance law" (1971) 34 M.L.R. 29; G.H. Treitel, The Law of Contract (4th ed., 1975) pp.264-265; Cheshire & Fifoot's Law of Contract (9th ed., 1976) p. 281.

140 See R.A. Hasson, supra, at 34-35.

141 See para. 106(b), below for a further criticism of "basis of the contract" clauses.

material to the risk. Secondly, they entitle insurers to repudiate the policy for an objectively inaccurate statement of fact even though the insured could not reasonably be expected either to know or to have the means of knowing the fact. Thirdly, the elevation into warranties of all such statements by the insured en bloc means that, if insurers can establish any inaccuracy, however trivial, in any of the statements, they can exercise their right to repudiate the policy, even though the statement was not material to the risk and even though the statement referred to matters beyond the insured's knowledge or means of knowledge. Such a repudiation is often referred to as an example of a repudiation on technical grounds.[142]

84. Insurers contend that in practice they only take advantage of "basis of the contract" clauses to repudiate a policy on technical grounds where they suspect fraud which they are unable to prove. However, it is in our view unsatisfactory for insurers to be able, on mere suspicion, to pre-empt the function of the courts. It should be for the courts, and only for the courts, to make findings of fraud.[143] It is to us quite unacceptable that insurers should in effect in many cases have a discretion to repudiate the policy on technical grounds; their entitlement in this regard should depend on law, and not be a matter of discretion.

85. The first ground of objection to "basis of the contract" clauses could be met by depriving them of legal effect merely to the extent that they are capable of turning statements in a proposal form which are not material into "warranties". This solution would not however go far enough,

142 Other examples of so-called "technical repudiations" are given in paras. 120-121, below.

143 See Law Reform Committee, Fifth Report (1957) Cmnd. 62, para. 11; "Aspects of Insurance Law" - a Report of the Contracts and Commercial Law Reform Committee of New Zealand (1975) para. 4; Issues Paper No. 2 of the Law Reform Commission of Australia, Insurance Contracts (June 1977) pp. 9-10.

since it would not fully meet the two other objections to which we have referred. Earlier in this working paper[144] we said that it might be unjust to the insured to require him to give objectively accurate answers to questions as to past and present facts which were outside his knowledge or means of knowledge. We accordingly reached the provisional conclusion[145] that such injustice could best be avoided by a provision that the insured should be treated as having discharged his duty of disclosure if he answers a question on a proposal form to the best of his knowledge and belief, having carried out all those enquiries which a reasonable man in his circumstances would have carried out, regardless of whether his answer is in fact inaccurate. In our view it would be unacceptable if insurers were able to circumvent the protection thus afforded to the insured by obtaining from him, by way of a "basis of the contract" clause, a warranty as to the accuracy of all his answers, and could then repudiate the policy on the ground that one such answer was inaccurate in circumstances where the insured, by complying with our requirements in regard to proposal forms, has discharged what we have recommended should be his duty of disclosure.[146]

Our provisional recommendation

86. Accordingly, our provisional recommendation is that "basis of the contract" clauses should be ineffective to the extent that they purport to create warranties as to past or present fact.

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144 See para. 70, above.

145 At para. 70, above.

146 See paras. 66 and 70, above.

Scope of our provisional recommendation

87. It will be seen that the scope of our provisional recommendation is limited to the purported application of "basis of the contract" clauses to statements as to past or present fact appearing in the proposal form. It is intended to prevent insurers from being able to treat such statements in a proposal form as though they were terms of the contract. The result of this provisional recommendation, taken together with our provisional recommendations concerning the insured's duty of disclosure,[147] will be as follows. If an insured makes an inaccurate statement of past or present fact in answer to a material question in a proposal form, when he either knows the truth or could have discovered it by making reasonable enquiries, he will be in breach of his duty of disclosure and the insurer will be entitled to repudiate the policy and reject any claim. If, however, despite the inaccuracy of his answer, it was true to the best of his knowledge and belief having carried out all reasonable enquiries, the insured will not be in breach of his duty of disclosure; and if there is a "basis of the contract" clause whereby he has purported to warrant the objective accuracy of his answers it will be ineffective and will not entitle the insurer to repudiate the policy for a breach of any such purported warranty.

We should however make it clear that we do not intend to prevent insurers from obtaining undertakings from the insured as to the existence of past or present facts. If insurers consider it necessary and proper from the point of view of underwriting practice to obtain such undertakings, we propose that they should be able to introduce them as individual warranties, provided that the formal requirements which we propose later[148] in regard to the creation of

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147 See paras. 66 and 70, above.

148 See para. 118, below.

warranties are satisfied. However, we should point out here that under our proposals concerning warranties[149] insurers will nevertheless not have an unrestricted right to repudiate the policy and reject any claim for any breach of a warranty.

Statements as to the future

88. Answers in a proposal form by the insured may not all relate to facts existing at or prior to the date of the contract; some of them may relate to the future. They may assert that a fact or a state of affairs will continue to be true or will continue to exist during the period of insurance or that the insured will do or refrain from doing something during that period. Obvious examples are statements by the insured that he will maintain precautions against fire and burglary on the insured premises. The effect of a "basis of the contract" clause when applied to such statements is to elevate them into promises by the insured as to the future: they are then often referred to as promissory warranties or warranties of a continuing nature and become terms of the contract of insurance. As such they have nothing to do with the insured's duty of disclosure. Accordingly we have nothing further to say about them at this stage but deal with them later.[150]

(d) Renewal

(1) Renewal where there has been a proposal form

89. One of the provisional recommendations which we have made in this working paper[151] is that a copy of the completed proposal form should be sent to the insured within a reasonable time of its submission to insurers. This recommendation is important in connection with the duty of disclosure on renewal for the following reason. In

149 See paras. 120-122, below.

150 See Part III.

151 See para. 77, above.

general, non-life insurance policies in England are contracts for a term of one year and are renewed annually by the offer and acceptance of the annual premium. The insured under the present law is under a fresh duty to disclose facts material at the date of renewal, since he is treated in law as making a new contract of insurance with the insurer on renewal.[152] The extent of the duty is the same as on the original application.[153] One criticism of the present law has been that an insured is not likely to be aware that he is under a repeated or fresh duty of disclosure whenever he renews his policy and that, even if he is so aware, he may find it difficult to remember what material changes in circumstances there have been since the conclusion of the initial contract of insurance unless he has kept a copy of his original proposal form. We recommend that if the insurer invites a renewal by the insured, the insured should be under a duty to disclose any material changes in circumstance in the past year and under a residual duty not deliberately to conceal known material facts. We also recommend, however, that the insured should be sent a notice referring him to the copy of the completed proposal form which was sent to him and giving prominence to both duties and to the consequences of their breach. The insured who applies for renewed cover without having been invited to do so by the insurer should be under a similar duty of disclosure even though he will not have been sent the notice.

(2) Renewal where there has been no proposal form

90. Where there has been no proposal form, we recommend that if the insurer invites a renewal by the insured, the

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152 In re Wilson [1920] 2 Ch. 28; Hearts of Oak Building Society v. Law Union & Rock Insurance Co. Ltd. [1936] 2 All E.R. 619.

153 Lambert v. Co-operative Insurance Society Ltd. [1975] 2 Lloyd's Rep. 485, 487.

insured should be under the modified duty of disclosure formulated in paragraph 60. The insured should be sent a notice in writing reminding him of his duty of disclosure and in particular of his duty to disclose any material changes in circumstances of material occurrences in the past year. The consequences of failure to comply with the duty should also be set out in the notice. The insured who applies for renewed cover without having been invited to do so by the insurer should be under the same duty of disclosure even though he will not have been sent the notice.

D. Our preference as regards the field of choice

91. We have reached the provisional conclusion that the duty of an insured to disclose material facts should be retained but that the rules relating to it should be modified in the manner which we have discussed in the immediately preceding paragraphs. We consider that such a reform would be clearly preferable to the introduction of the proportionality principle into English law.

E. Should the insurer's rights in respect of non-disclosure be further restricted?

92. Under the existing law we have seen[154] that the insurer has the right, on notice of the failure by the insured to comply with the duty of disclosure or within a reasonable time thereafter, to repudiate the contract of insurance and to reject a claim even if the loss has occurred before he has notice of the non-disclosure. We do not suggest any change in this aspect of the present law. It may however be argued that the provisional recommendations which we have made concerning non-disclosure do not go far enough to protect the interests of the insured and that the insurer's right to reject a claim for non-disclosure should be restricted in a way similar to that proposed by us

154 See para. 25, above.

later[155] in relation to breaches of warranty. The recommendation which might be applied in the present context would entail the insurer not being entitled to reject a claim if the insured could establish in the circumstances of a particular case that the non-disclosed fact could have had no connection with the loss which actually occurred.[156]

93. At first sight it seems attractive to require some nexus between the actual loss and the fact which the insured failed to disclose. But we think that on further consideration this approach would be open to a number of serious objections.

94. First, it is difficult to see how any "nexus" test would work in practice in the context of non-disclosure. There are many facts which, although material to the risk, are relevant more to the characteristics of the insured himself than to the nature of the risk. One example is a fact relevant to "moral hazard"; others are the refusal of cover by other insurers, the imposition of special terms in previous contracts or a substantial claims history. How would a court be able to determine that there could have been no connection between such facts, assuming that the insured had failed to disclose them, and any particular loss?

95. Secondly, we consider that a change in the law on these lines would erode the insurer's rights in the event of a breach by the insured of the duty of disclosure to an unacceptable degree. The duty of disclosure has in the past been a cornerstone of the rules relating to the formation of a contract of insurance and, as we have mentioned above,[157] we

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155 See paras. 120-122, below.

156 See para. 121, below.

157 See para. 51, above.

consider that it should so remain. The insurer's right to avoid a contract of insurance ab initio for non-disclosure entails the right to contend that he would never have made a contract on those terms if he had known the non-disclosed facts and therefore also the right to reject any claim made prior to his discovery of the non-disclosure. A limitation on these rights would mean that non-disclosure could no longer be regarded as a factor vitiating the formation of the contract. Furthermore, one consequence of the adoption of a "nexus" test would almost certainly be a rise in premiums, perhaps a substantial one, to take account of a possible increase in "sharp practice" by insureds.

96. The provisional recommendations in this Part are designed to strike a balance between the interests of the insurer and of the insured by providing adequate protection to the insured while at the same time preserving the conditions necessary for the insurer to carry on his business on a sound commercial footing. We consider that any proposals on the lines just discussed would upset that balance and are therefore undesirable.

We would welcome comments on the question whether the introduction of a "nexus" test would be desirable. If such a test is considered desirable we invite indications as to how it could be made to work in practice.

F. Summary of provisional conclusions and recommendations on non-disclosure

97. The proposals set out below are a summary of the provisional conclusions and recommendations contained in this Part. They do not represent concluded views but are intended as a basis for discussion on which we invite comments.

(a) The present law of non-disclosure is in need of reform (paragraphs 36-42).

(b) The insured should however continue to be subject to a duty of disclosure (paragraphs 45-52) and the legal remedies for its breach should remain unchanged; in particular we consider that the proportionality principle would not be a desirable innovation in this country (paragraphs 52-57).

(c) The ambit of the insured's duty of disclosure should however be modified and should be different according to whether or not a proposal form has been completed by him (paragraphs 58-77).

(d) Where there is no proposal form the insured should be under a duty to disclose those facts which a reasonable man in his circumstances would consider to be material in the sense that they would influence the judgment of a prudent insurer in accepting the risk or fixing the premium. The insured should however only be under a duty to disclose facts which he either knows or which a reasonable man in his circumstances ought to know (paragraphs 59-64).

(e) Where a proposal form has been completed by the insured the insurer should, subject to (i) below, be taken to have waived the insured's duty in regard to any fact outside the scope of the questions asked (paragraph 66).

(f) The insured should prima facie only be considered to have discharged his duty of disclosure if he supplies complete and accurate answers to the material questions asked in a proposal form (paragraph 67).

However, if the insured can prove that he has answered a material question in a proposal form to the best of his knowledge and belief, having carried out all those enquiries which a reasonable man in his circumstances would have carried out, he should be considered to have discharged his duty of disclosure, notwithstanding that the answer is in fact inaccurate (paragraphs 69-70).

(g) There should be a presumption that questions asked in a proposal form and the answers to them are material, but the insured should be able to rebut this presumption by proving that the question related to a fact which would not have influenced the judgment of a prudent insurer in accepting the risk or fixing the premium (paragraph 68).

(h) In deciding whether a written document is a proposal form for this purpose, the court should have regard to the document as a whole: the test should be whether the document was such as to lead a reasonable man to suppose that no further information was required to be disclosed by him. The court should look at the questions asked: if detailed questions were asked of the type usually asked by insurers for the purpose of deciding whether to accept the risk and what premium to charge and if they appeared comprehensive we would expect the court to hold that the document was a proposal form. The court should not be bound by any statement in the document which purports to describe its nature (paragraph 71).

(i) A residual duty should be imposed on the insured not deliberately to conceal facts which he knows to be material and of which he has actual knowledge even if they are outside the ambit of all the questions asked in the proposal form. In the event of a breach of this duty by the insured the insurer should be entitled to repudiate the policy and reject any claim that has arisen. The insurer should be required to give clear and prominent notice of this duty in the proposal form and to warn the insured of the consequences of breach (paragraph 73).

(j) Insurers should not be entitled to ask a "general question" such as "Are there any other facts which you, as a reasonable insured, consider would influence the judgment of a prudent insurer in fixing the premium or accepting the risk?" An insured should be entitled to ignore any such question and insurers should be deprived of any remedy in respect of false information supplied in answer to any such question. However, insurers should be entitled to ask specific questions on any topics which they regard as material (paragraph 74).

.) Where a question in a proposal form might reasonably be understood in two senses, one favourable to the insurer and the other favourable to the insured, the court ought always to construe it in the latter sense (paragraph 76).

(l) The insured should be entitled to receive a copy of the completed proposal form within a reasonable time of its submission to insurers (paragraph 77).

(m) The present law as to the legal effect of "basis of the contract" clauses is unsatisfactory and in need of reform (paragraphs 80-82).

(n) "Basis of the contract" clauses should be ineffective to the extent that they purport to create warranties as to past or present fact (paragraphs 83-86).

(o) Where there has been a proposal form, and the insurer invites a renewal by the insured, the insured should be under a duty to disclose any material changes in circumstances in the past year and under a residual duty not deliberately to conceal known material facts. The insured should be sent a notice referring him to a copy of the completed proposal form which was sent to him and giving prominence to both duties and to the consequences of their breach. The insured who applies for renewed cover without having been invited to do so by the insurer should be under a similar duty of disclosure even though he will not have been sent the notice (paragraph 89).

(p) Where there has been no proposal form, and an insurer invites a renewal by the insured, the insured should be under the modified duty of disclosure formulated at (d) above. The insured should be sent a notice reminding him of this duty of disclosure and in particular of his duty to disclose any material changes

in circumstances or material occurrences in the past year, and warning him of the consequences of breach. The insured who applies for renewed cover without having been invited to do so by the insurer should be under the same duty of disclosure even though he will not have been sent the notice (paragraph 90).

PART III - WARRANTIES

A. The present law

Introduction

98. Today it is common insurance practice for a contract of insurance to contain a number of stipulations both as to the existence or continuation of a certain state of affairs and as to the performance or non-performance of some act by the insured. Many of these stipulations amount to what are generally known in insurance law as "warranties". We must examine the present law as to warranties in order to ascertain the manner in which they are created and their precise legal effect.

What is a warranty?

99. The word "warranty" is used in insurance law in a special sense to denote a term of the contract of insurance which must be strictly complied with and upon any breach of which, however trivial, the insurer is entitled to repudiate the policy.[158] It follows that upon a breach of a warranty the insurer has the right to repudiate the whole contract from the date of the breach regardless of the materiality of the term, the state of the mind of the insured, or of any connection between the breach and the loss.[159] The meaning of warranty in insurance law is thus similar to the meaning of "condition" in the law of sale of goods.[160] The promise which forms the

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158 Pawson v. Watson (1778) 2 Cowp. 785, 787; 98 E.R. 1361, 1362 per Lord Mansfield; De Hahn v. Hartley (1786) 1 T.R. 343; 99 E.R. 1130. See also the Marine Insurance Act 1906, s. 33(3).

159 See generally MacGillivray & Parkington on Insurance Law (6th ed., 1975) chap. 10, esp. paras. 635-638 and 814-912. See also paras. 79, above and 103, below.

160 See the Sale of Goods Act 1893, s. 11(1)(b).

ubject-matter of a warranty consists of an undertaking by he insured that some particular thing shall or shall not be one or whereby he affirms or negatives the existence of a articular state of facts.[161]

reation of warranties

00. A warranty may be created in one of the following ays:

(a) by the use of the word "warranty"; for example, "the insured warrants ...";

(b) by an express provision for strict compliance and the right to repudiate for breach;[162]

(c) by the use of phrases such as "condition precedent"[163] from which the court can infer that the parties intended strict compliance and the right to repudiate;

(d) by the use of any words provided that the court concludes that, on the true construction of the whole document containing the term, the parties intende the term to possess the attributes of a w ranty;

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61 This is taken from the Marine Insurance Act 1906, s. 33(1) but is also apt in the context of non-marine insurance.

62 For example, the standard clause in fire policies requiring notification of any increase in the risk.

63 In insurance law it is more convenient and clearer to restrict the word "condition" to terms upon breach of which the insurer will at most be able to reject a claim in respect of a particular loss: see MacGillivray & Parkington, op. cit., para. 639. Conditions will generally concern collateral promises by the insured e.g. concerning the time within which notice of loss must be given, or terms which confer particular rights on the insurer.

(e) by the use of a "basis of the contract" clause.[164]

Types of warranty

101. A warranty may relate to a state of affairs existing in the past or in the present: such a warranty will generally arise from the application of a "basis of the contract" clause to the contents of a completed proposal form. We have dealt with the creation of warranties as to past and present fact by "basis of the contract" clauses in Part II[165] and so need say little further about them here save to point out that such warranties may sometimes appear on the face of the policy independently of a "basis of the contract" clause.[166] A warranty may on the other hand relate to the future; it is often then referred to as a "promissory warranty"[167] or a warranty of a continuing nature and we deal with this type of warranty below. A term may also, on its proper construction, constitute both a warranty as to past or present fact and a promissory warranty.

Promissory warranties

102. Whether the terms in a proposal form or a policy constitute promissory warranties turns on their precise wording.[168] As regards proposal forms, a clear reference

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164 See paras. 78-88, above for a discussion of "basis of the contract" clauses.

165 See paras. 78-88, above.

166 Insurers will, under our proposals, continue to be allowed to introduce such warranties by incorporating them as individual terms on the face of the policy: see para. 118, below.

167 Cf. the meaning of "promissory warranty" in the Marine Insurance Act 1906, s. 33(1).

168 Compare Grant v. Aetna Fire Insurance Co. (1862) 15 Moo. P.C.C. 516; 15 E.R. 589 and Grant v. Equitable (1864) 14 Low. Can. R. 493. See MacGillivray & Parkington on Insurance Law (6th ed., 1975) chap. 10, para. 857.

to the future in a particular question or statement will always suffice;[169] without such a reference, a provision will not normally be a promissory warranty,[170] but the warranty may still be treated as a promissory warranty if that is the only real purpose which the provision could serve. This is particularly likely to be the case in property insurance in respect of warranties as to the use of the premises and the precautions to be taken against loss;[171] for example, a warranty in a fire policy as to the presence on premises of fire sprinklers or extinguishers or a warranty forbidding the introduction of inflammable goods on the premises.[172]

103. The insured is required to comply with a promissory warranty throughout the period of insurance. Any breach entitles the insurer to repudiate the policy from the date of breach. He remains liable for claims made in respect of prior losses, if any, but is entitled to reject claims in respect of losses occurring subsequently.

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169 A question in a proposal form may refer to the future as well as to present facts: see Dawsons Ltd. v. Bonnin [1922] 2 A.C. 413. If the provision can only be read as to the future it will be a promissory warranty: see Beauchamp v. National Mutual Indemnity [1937] 3 All E.R. 7 .

170 Woolfall & Rimmer v. Moyle [1942] 1 K.B. 66; Kennedy v. Smith and Ansvar Ins. Co. Ltd. 1976 S.L.T. 110.

171 Sillem v. Thornton (1854) 3 E. & B. 868; 118 E.R. 1367; Hales v. Reliance Fire & Accident Ins. Co. [1960] 2 Lloyd's Rep. 391.

172 As in Hales v. Reliance Fire & Accident Ins. Co. [1960] 2 Lloyd's Rep. 391.

Warranties of opinion

104. If a particular question or the general declaration on a proposal form requires the insured to warrant only his opinion as to the truth of his answers, there will be a breach of warranty only if the insured dishonestly supplies an incorrect answer.[173]

Interpreting warranties contra proferentem

105. If there is any doubt as to the scope of a warranty, whether it is as to present or past fact or promissory or both, it will be construed contra proferentem, that is, against the insurer who drafted it.[174] This is a rule whereby any ambiguity in a document prepared by an insurer should be construed strictly against him.

B. Criticisms of the present law

106. Earlier[175] we set out the criticisms that have been attracted by the right of insurers under the present law to create warranties by means of "basis of the contract" clauses. We have however three additional criticisms of the present law of warranties:

(a) It seems to us quite wrong that an insurer should be entitled to demand strict compliance with a warranty which is not material to the risk and to repudiate the policy for a breach of it;

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173 Huddleston v. R.A.C.V. Insurance Pty. Ltd. [1975] V.R. 683.

174 Provincial Ins. Co. v. Morgan [1933] A.C. 240 (promissory warranty arising from proposal form); Shaw v. Robberds (1837) 6 Ad. & E. 75; 112 E.R. 29 (promissory warranty arising from policy document).

175 See paras. 80-82, above.

(b) Material warranties are of such importance to the insured that he ought to be able to refer to a written document in which they are contained.[176] However, a promissory warranty may not appear on the face of the policy but may be created by means of a "basis of the contract" clause in the proposal form.[177] As a result, the insured, who will generally not be supplied with a copy of the proposal form,[178] may well not remember important undertakings made by him, even though his rights of recovery under the policy may depend upon strict compliance with them.[179]

(c) We think it unjust that an insurer should be entitled to reject a claim for any breach of even a material warranty, no matter how irrelevant the breach may be to the loss.

Our provisional view

107. Our provisional view is that the present law of warranties fails to strike a fair balance between the insurer and the insured and that it should therefore be changed.

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176 See also E.R.H. Ivamy "Insurance Law Revision" (1955) 8 C.L.P. 147, 158.

177 See para. 79, above.

178 See para. 89, above.

179 See also MacGillivray & Parkington on Insurance Law (6th ed., 1975) chap. 10, para. 815.

C. Reform of the present law - the field of choice

Introduction

108. Having described and criticised the present law we consider two possible ways in which it can be reformed:

(i) The abolition of warranties and the substitution of a continuing duty to notify increases of the risk, together with a provision that in the event of a breach the insurer's liability to pay claims should be governed by the proportionality principle.

(ii) A modified system of warranties: that is a system including provisions that a warranty should only be effective if it is material to the risk, and provisions limiting the right of the insurer to reject a claim for any loss when there has been any breach of a material warranty, where the breach is quite irrelevant to the loss.

(i) The abolition of warranties

109. A possible approach to reform would be to replace promissory warranties by a continuing duty on the insured to disclose to the insurer new circumstances or changes in circumstances which are either material or of which the insurer has requested notification in the contract. Claims arising after a breach of this duty by the insured would be paid in the proportion which the premium actually paid bears to the premium which would have been charged had the true risk been known (the proportionality principle). This is broadly the

approach taken by Article 3 of the draft directive which is discussed in detail in Part IV.[180]

110. Two basic features of this approach are not known to English law:

(i) there would be a continuing duty of disclosure after the contract of insurance has been made;

(ii) the insurer would be obliged to pay only a proportion of the claim, based on the ratio between the actual premium and a notional premium.

111. A continuing duty of disclosure seems somewhat draconian. The insured would have to be constantly alert to relevant changes of circumstances, and this might be particularly onerous on the private individual who has several policies. A good deal of the sense of security and peace of mind which should be provided by insurance might well be lost. In our view this approach may be appropriate for long-term cover extending over a period of several years which is a feature of Continental insurance practice, but we think that it is inappropriate where cover is renewed annually, as is generally the case in this country.

112. Of equal importance from the insurer's point of view, this approach would prevent him from laying down conditions which he thinks are commercially necessary for the cover in question. For example, we think that it would be wholly impracticable to expect the insurance market to provide fire insurance without being entitled to impose

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180 See paras. 147-157, below.

warranties on the insured with regard to such matters as sprinkler systems and other precautions and without being entitled to repudiate the policy if these precautions are not being observed.

113. It seems to us that the difficulties in the practical application of the proportionality principle in this country to which we have already referred in paragraphs 55 and 56 above apply to the same extent, and perhaps a fortiori, when applied to a continuing duty of disclosure.[181]

Our provisional conclusion

114. Our provisional conclusion is that this approach would not be appropriate for contracts other than those of long duration and that it would be undesirable to superimpose it on English insurance law and practice.

(ii) A modified system of warranties

Limitation of warranties to terms material to the risk

115. In our view the system of warranties in English insurance law should be retained, but should be modified to the extent necessary to accommodate the criticisms we have made. In the present law the characteristic of a warranty is, as we have seen,[182] that any breach entitles the insurer to repudiate the policy. However, we consider that insurers should not be entitled to repudiate a policy for the breach of an undertaking which is immaterial to the risk, even if the word "warranty" is used or if, on the true construction of the contract, the courts conclude that the parties intended such a result. Accordingly, we make the provisional recommendation

181 See para. 153, below for a description and analysis of the relevant provision of the draft directive.

182 See para. 99, above.

that a term of the contract should only be effective as a warranty if it is material to the risk, in the sense that it is an undertaking which would influence a prudent insurer in deciding whether to accept the risk and if so at what premium.

Onus of proof of materiality

116. Since the materiality or otherwise of a particular warranty depends on its influence on the judgment of a prudent insurer whether or not to take the risk and if so at what premium, it would be inappropriate and unduly harsh on the insured if the onus of disproving materiality were placed on him. The onus should accordingly be on the insurer to prove that the warranty broken was material to the risk.

Types of warranty

117. As we have seen, warranties are of two types: warranties as to past or present fact, and promissory warranties. In view of our provisional recommendation as regards "basis of the contract" clauses insurers wishing to introduce warranties of the first type will no longer be able to do so by means of a general declaration by the insured in a proposal form; insurers will have to introduce them individually in compliance with the formal requirements set out in the paragraph next following. However, we anticipate that, as a matter of underwriting practice, insurers will only find it necessary to introduce such warranties in relatively few cases, usually as the outcome of negotiations with the insured. Thus although the provisional recommendations in this Part are intended to apply both to warranties as to past or present fact and to promissory warranties they will be applicable in the main to promissory warranties.

Formal requirements for warranties

118. We now turn to the second of the three criticisms of the law of warranties which we made in paragraph 106. This was to the effect that it would be desirable for an insured to be able to refer to a written document which contains the material warranties by which he is bound. In our view the insured should be entitled to be furnished by

the insurer with such a document within a reasonable time of his giving the warranty in question as a condition precedent to its legal effectiveness. Where he has completed a proposal form containing promissory warranties he ought accordingly to be entitled to receive a copy of it as completed and it will be recalled that we have made a provisional recommendation to this effect.[183] Where no proposal form has been completed and the insured has given a promissory warranty or a warranty as to past or present fact[184] we consider that it should be incorporated as an individual term on the face of the policy (or in an endorsement thereon) if there is one. However, we are aware that in some cases, for example where short-term cover is granted, no policy is ever issued and that in others, for example, where provisional cover is granted a policy may not be issued within a reasonable time of the warranty having been given. In the case of provisional cover, a warranty may often be given over the telephone. In all such cases the insurer should be required to confirm, in writing and within a reasonable time, the warranty given by the insured. This may be done in a cover-note, in a certificate of insurance or even by a letter. If the insurer fails to comply with these formal requirements he should in our view be precluded from relying on a breach of the warranty in question in order to repudiate the policy or reject a claim. Nevertheless, if a loss occurs in the interim, before a reasonable time has elapsed for the provision by the insurer of such written confirmation, then the insurer should be entitled to rely on an oral warranty.

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183 See para. 77, above.

184 Our provisional recommendations as regards "basis of the contract" clauses will make it impossible for insurers to create warranties as to past or present fact in the proposal form: see paras. 86 and 117 above.

egal effect of a breach of warranty

19. If the insurer succeeds in discharging the onus of roving that the broken warranty was material to the risk, hen, provided that the formal requirements referred to in he preceding paragraph are satisfied, he will be entitled o repudiate the policy as from the date of the breach, with he consequence that, if he does so, he can also reject all laims for losses occurring after repudiation. This is his ight under the present law.[185] However, his right to eject a particular claim for a loss occurring prior to epudiation should in our view be restricted in the manner xplained in the paragraphs which follow.

oss of a nature outside the purpose of broken warranty

20. Generally, if a particular warranty is material to he risk, the commercial purpose of the warranty will be to uard against losses relevant to the type of insurance in uestion, and losses which occur in practice will generally e losses of this type. Thus the purpose of warranties in ire policies will be to guard against loss by fire and the urpose of warranties in a burglary policy will be to guard gainst loss by burgl . There may however be claims in ituations where ther has been a breach of a material arranty but where the nature of the loss in question could ave had no connection whatever with the commercial purpose f the warranty. In such cases the breach would be clearly rrelevant to the loss and we are at present firmly of the iew that it would be unjust to permit the insurer to eject the claim. In order to illustrate types of loss utside the commercial purpose of a warranty we set out a umber of examples. When considering these examples it must e borne in mind that all the warranties mentioned are

185 See paras. 79, 99 and 103, above.

clearly material in the context of the particular type of insurance, and that under the present law the insurer can reject every claim in all these cases.

(a) A warranty in a motor policy that the vehicle is to be kept in a roadworthy condition. The warranty is broken. The vehicle is then stolen. It seems to us that a rejection of the claim in such a case would be "technical" and should not be permitted, because the type of loss which has occurred, that is theft, was unrelated to the commercial purpose of this warranty.

(b) A broken warranty as in (a) but the vehicle is run into while it is parked without anyone in it. It seems to us that in this case it should be open to the insured, if he establishes these facts, to resist rejection of the claim on the same ground as in (a).

(c) A warranty in a motor policy that the insured has had a driving licence for 10 years. He has in fact only held it for 9 years. The vehicle is stolen. It seems to us that in this case, as in (b), rejection of the claim should not be permitted: the purpose of the warranty

was not to guard against the type of loss which in fact occurred.

(d) A warranty in a fidelity policy that the insured employer will engage no one without first having taken up satisfactory references. The employer fails to do so in relation to employee A who steals his employer's money. It seems to us that the insurer should clearly be entitled to reject the claim, because the commercial purpose of the warranty was to guard against this very type of loss; it should not be open to the insured to resist this by seeking to show, for instance, that A would have produced satisfactory or forged references if he had been asked for any.

Connection between the breach of warranty and the actual loss

121. Although the insurer should generally be entitled to reject a claim for breach of a material warranty if the purpose of the warranty was to guard against the loss of the type which has in fact occurred, it is still necessary to examine whether any breach of such a warranty should entitle the insurer to reject a claim in respect of any loss of such type. The simple case is when the breach is directly connected with, or even causative of, the loss. It seems self-evident that the insurer must be entitled to reject the claim in such cases - for example, where the extent of a loss by fire may have been increased by the breach of a warranty to maintain a sprinkler system, or where there has been a loss by burglary and the entry by the thieves may have been facilitated by the breach of a warranty to maintain

a burglar alarm. However, there will also be cases in which it would in our view be unjust to permit the insurer to rely on the breach, because there may be no possible connection between the breach and the actual loss. In order to illustrate the different situations which can arise we set out a number of further examples in which there are different degrees of connection between the breach and the loss, together with some comments. Again it must be remembered when considering these examples that all the warranties are clearly material in the context of the particular type of insurance and that under the present law the insurer can reject every claim in all these cases.

(e) The facts as in (d) in the preceding paragraph, but the theft is committed by employee B who has supplied satisfactory references. It seems to us that, although the type of loss (breach of fidelity) lies within the commercial ambit of the warranty broken in relation to employee A, this fact should not entitle the insurer to reject the claim if the insured can establish that there could have been no connection between the breach in relation to A and the theft by B.

(f) A warranty in a fire policy on a factory that an efficient sprinkler system will be maintained throughout. A fire occurs in a workshop at one end of the factory where the system is properly maintained, but there is no such system in a workshop at the other end to which the fire does not spread. It seems to us that on proof of these facts the insured should be entitled to recover for the same reasons as in (e) above.

(g) A warranty in a burglary policy that a burglar alarm will be maintained on all doors and windows to the premises. The insured fails to maintain the burglar alarm in working condition. Thieves gain entry by tunnelling or by making a hole in the ceiling, and a loss occurs. It seems to us that the insured should only be able to recover if he can establish that in all the circumstances his failure to maintain the burglar alarm could have had no connection with the loss which occurred.

Although such examples in themselves represent unusual situations in comparison with the general run of insurance claims, they could of course be multiplied indefinitely. In many, perhaps the great majority, the answer which justice requires may well be obvious. However, in some it will not be, and it is necessary to devise a satisfactory test for dealing with all of them. The test which we propose is the test suggested by example (g) above: the insurer should only be deprived of his right to reject a claim for a breach of a material warranty the purpose of which was to guard against loss of the type which in fact occurred, if the insured can establish that the breach could have had no connection with the actual loss. We will first elaborate upon the test which we propose and then discuss shortly other tests which we have considered and rejected.

Our proposed test

122. A more detailed explanation of the test which we propose is as follows:

(a) The warranty must be material to the risk.

(b) The type of loss must fall within the commercial purpose of the warranty.

(c) If (a) and (b) are satisfied, then *prima facie* the insurer should be entitled to reject the claim.

(d) However, if the insured can prove that the breach could have had no connection with the actual loss, it would in our view be unfair to allow the insurer to reject the claim.

Placing the onus under (d) on the insured requires little comment. Apart from the fact that the overriding test should be that under (c), so that the onus of satisfying (d) should naturally fall on the insured, the necessary facts in order to seek to satisfy (d) would usually be likely to be within the knowledge of the insured, rather than the insurer.

Other possible solutions

123. We must mention a number of possible alternative solutions which we have considered in relation to paragraphs 120 - 122 which appear unsatisfactory to us.

(a) A test of "reasonableness"

For the reasons already stated above,[186] we do not consider it satisfactory to maintain the law in its present form subject to the self-imposed "Statements of Practice" concerning "consumer" insurance which are not legally enforceable and under which the insurers are themselves the judges of reasonable grounds for repudiation. The question is then whether a test of

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186 See paras. 4-10, above.

reasonableness should be left to the courts. Although we were in favour of such a test in the context of exemption clauses in contracts of insurance,[187] these were ultimately omitted from the scope of the Unfair Contract Terms Act 1977. Experience will no doubt show whether this policy decision was right, but we can certainly see no stronger reason for applying a reasonableness test to breaches of material warranties than for applying such a test to exemption clauses. One can see that such a test might in any event be open to the criticism that it creates too much uncertainty: the warranty on which the insurer would seek to rely would almost certainly be reasonable in itself, since its materiality to the cover in question is assumed. The issue for the court would therefore be whether in all the circumstances it is reasonable that the insurer should be entitled to reject a claim on the ground of a breach of it. This may well be thought to be too wide, at any rate without some guidelines which would in themselves have to include the kind of tests which we are here considering. We therefore think that it would be better to devise a definitive test.

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187 See our Second Report on Exemption Clauses (1975) Law Com. No. 69; Scot. Law Com. No. 39, paras. 245-247.

(b) Causation

We considered a test simply based on causation, that is that insurers should be entitled to reject a claim for a breach of any material warranty unless the insured shows an absence of any causal connection between the breach and the loss. Our main reason for rejecting this test is that it might often lead to injustice to the insurer and would in any event be likely to lead to a flood of litigation, often without providing any satisfactory answer. For instance, in example (d) in paragraph 120 above, we think that this would be the case. It seems to us that in this case the insurer should be entitled to reject the claim even in the absence of any provable causal connection, because the commercial purpose of the warranty is clearly to guard against the risk of the actual loss, and because the breach is prima facie sufficiently closely connected with it to lead to the conclusion that the absence of any causal connection should be regarded as irrelevant. In example (d) it might well be unclear whether or not the employer would have engaged employee A had he taken up references, and this should clearly be irrelevant to the insurer's right of rejection; similarly the employer should

in such a case not be entitled to invoke the argument that the references would have been wholly satisfactory if he had taken them up. In such cases a test requiring causal connection between the breach and the loss would not provide any satisfactory answer; yet common sense would in our view dictate that insurers should be entitled to reject the claim. Otherwise the safeguard to the insurer of compliance with material warranties would be substantially eroded.

(c) Reasonable foreseeability

Another test which we have on balance rejected is whether at the time of the breach it would have been reasonably foreseeable that the actual loss might ensue from the breach in question. At first sight this appears to be a more attractive test than that of causal connection, because the courts have on the whole found reasonable forseeability a satisfactory and flexible test in the law of tort. However, we think that although this test has proved satisfactory in determining whether a "duty" relationship exists between A and B by reason of their situation vis-a-vis each other, it has proved much less satisfactory when used as a basis for deciding whether A is legally liable to B for an actual loss of a particular type which B has sustained as a result of a breach by A. Its application for this purpose in the rules as to remoteness of damage in the law of tort has given rise to difficult

distinctions and a network of case-law which is far from satisfactory.[188] One only has to apply this test to the example referred to in (b) above to see that very similar difficulties would arise.

Our provisional conclusion

124. Our provisional conclusion is that, of the two approaches to reform of the law of warranties which we have considered in this Part, the modified system of warranties discussed in paragraphs 116 to 122 is to be preferred to the abolition of warranties and their replacement by a continuing duty of disclosure, as discussed in paragraphs 110 to 115.

Summary of provisional conclusions and recommendations on warranties

125. The proposals set out below are a summary of the provisional conclusions and recommendations contained in this Part. They do not represent concluded views but are intended as a basis for discussion. Comments are invited.

(a) The present law of warranties fails to strike a fair balance between the insurer and the insured and ought therefore to be changed (paragraphs 106-107).

(b) The system of warranties should be retained; in particular a continuing duty to notify increases of the risk would not be appropriate for contracts

188 See, for example, Smith v. Leech Brain [1962] 2 Q.B. 405 and Tremain v. Pike [1969] 1 W.L.R. 1556.

other than those of long duration and it would be undesirable to superimpose it on English insurance law and practice (paragraphs 109-114).

(c) The system of warranties should however be modified: a term should only be effective as a warranty if it is material to the risk and the right of the insurer to reject a claim where there has been a breach of a material warranty should be restricted (paragraphs 115-123).

(d) A term of a contract of insurance should only be effective as a warranty if it is material to the risk, in the sense that it is an undertaking which would influence a prudent insurer in deciding whether to accept the risk and if so at what premium (paragraph 115). The onus should be on the insurer to prove that the warranty broken was material to the risk (paragraph 116).

(e) If the insurer discharges the onus of proving that the broken warranty was material to the risk, and the formal requirements described in (g) below have been satisfied, he will be entitled to repudiate the policy as from the date of the breach with the consequence that he can also reject all claims for losses occurring after repudiation (paragraph 119).

(f) The insurer should be entitled to reject a claim in respect of a loss occurring after the date of the breach of a material warranty but before repudiation of the policy if the purpose of the warranty was to guard against a loss of the type which in fact occurred, unless the insured establishes, in the circumstances of a particular case, that the breach could have had no connection with the loss (paragraphs 120-123).

(g) Where no proposal form has been completed and the insured has given a promissory warranty or a warranty as to past or present fact it should be incorporated as an individual term on the face of the policy (or in an endorsement thereon) if there is one. If however no policy is ever issued, or if no policy is issued within a reasonable time of the warranty having been given, the insurer should be required to confirm, in writing and within a reasonable time, the warranty given by the insured. If the insurer fails to comply with these formal requirements he should be precluded from relying on a breach of the warranty in question in order to repudiate the policy or reject a claim. Nevertheless, if a loss occurs in the interim, before a reasonable time has elapsed for the provision by the insurer of such written confirmation, then the insurer should be entitled to rely on an oral warranty (paragraph 118).

PART IV - AN ALTERNATIVE APPROACH: THE DRAFT DIRECTIVE

General

126. The proposals contained in Articles 2, 3 and 4 of the draft directive would provide an alternative to those rules of our present law of insurance which fall within their scope. Article 2 deals with the duty of the insured to provide certain information to the insurer prior to the conclusion of the contract; both the ambit of the duty and the consequences of a breach differ from our present law of non-disclosure. It therefore provides an alternative approach to the law of non-disclosure. Article 3 deals with the duty of the insured to declare certain changes in circumstances which occur after the contract has been concluded and once again the consequences of its breach are set out. Under our present law no such duty exists but the insurer is of course entitled to include warranties in the contract of insurance with which the insured is bound strictly to comply. Article 4 deals with the effect of a diminution of the risk while the contract is in force; our present law makes no provision in this regard. Articles 3 and 4 thus provide an alternative to our present system of warranties.

127. The considerations of policy underlying the three Articles are, first, that the insurer should be given the protection he needs in order to be able to run his business and, secondly, that the insured should be given the protection and security which he is entitled to expect from a contract of insurance. The purpose of the Articles, taken together, is to strike a fair balance between these considerations. Our present law gives effect to the former consideration but at the expense of the latter[189] and we think it right that a fairer balance should be struck. We therefore welcome Articles 2-4 as a move in the right direction. However, we are not convinced that they provide the best way of striking a fairer

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189 See paras. 35-41, 80-81, and 106, above.

balance. We now turn to the detailed provisions of each Article. In analysing them we have sought to make clear to the reader how they would work in practice even where the provisions in question are not directly relevant to our proposals for reform. On the other hand we are not purporting to put forward an exhaustive analysis of Articles 2-4 in the paragraphs which follow.

(i) Alternative approach to the law of non-disclosure

Article 2

Introduction

128. In Part II of this working paper we have considered three possible ways of reforming our law of non-disclosure. The second of these ways (which we do not recommend) is the retention of the existing duty of disclosure but the introduction of the proportionality principle. This is substantially the approach taken by Article 2 of the draft directive. The Article contains detailed provisions with regard to the insured's duty of disclosure prior to the making of a contract of insurance, the various ways in which the duty may be broken, the consequences of breach in each case and the effect of breach on subsequent claims. The provisions appear to be intended on the one hand to provide the insurer with all the information he needs for the assessment of the risk at the date the contract is entered into and on the other to enable the insured to make a proportionate recovery of his claim where his breach does not justify the rejection of the claim in its entirety. In this way the Article seeks to balance the interests of insurer and insured.

129. The provisions of Article 2 differ from our present law in two major respects. First, whereas under our law a material non-disclosure by the insured entitles the insurer to repudiate the policy irrespective of whether the insured

has acted innocently, negligently or fraudulently,[190] the consequences of a breach of the duty prescribed by Article 2 depend upon the nature of the insured's breach.[191] Secondly, whereas under our law a material non-disclosure by the insured entitles the insurer to refuse to pay any part of a claim, Article 2 permits proportionate recovery in some cases.[192] We must now examine the provisions of Article 2 in more detail.

The duty

130. Article 2(1) provides that prior to the conclusion of the contract the insured shall disclose to the insurer any circumstances of which he is aware which may influence the insurer's assessment or acceptance of the risk, save for circumstances already known to the latter or which are common knowledge. Facts as to which specific questions are asked in writing are to be regarded as material in the absence of proof to the contrary and the insured must reply to them fully and accurately.

131. The duty differs slightly from the existing duty of disclosure in English law in that the materiality of a particular fact is to be judged not by reference to whether it would influence the assessment of the "prudent insurer"[193] but by reference to whether it would influence the assessment of the actual insurer. The drawback in both cases is that the standard of disclosure that the insured is required to meet is one which he has no means of assessing.[194] With regard to the test in Article 2(1) it seems to us that in practice it would be exceedingly difficult for the insured to lead evidence to controvert that of the actual insurer.

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190 See para. 25, above.

191 See paras. 138-140, below.

192 See para. 143, below.

193 See paras. 23-24, above.

194 See paras. 37-38, above.

132. The insured's duty is confined to the disclosure of those circumstances of which he is aware. An insured would not therefore be in breach of his duty if he failed to disclose facts which he did not know but which he ought to have known. We think that there is a case for attributing to the insured some degree of constructive knowledge[195] and our view is shared by the Comité Européen des Assurances[196] (hereafter referred to as the C.E.A) who have suggested that the duty should extend to circumstances known to the insured or which he can reasonably be expected to know.

133. There is a presumption that facts as to which specific questions have been asked in writing are material. This presumption seems to assume the use of proposal forms by insurers.[197] While we agree that there should be a presumption that facts as to which questions have been asked on a proposal form are material, our provisional view, as explained in Part II,[198] is that no fact should be treated as material unless it forms the subject-matter of a question in the proposal form. We also agree that the insured should provide full and accurate answers to specific questions in writing.

Ways in which the duty may be broken

134. Article 2 lays down three ways in which the duty may be broken by the insured:

(i) Under Article 2(2) he may have broken it innocently;[199]

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195 For our provisional recommendation in this respect, see paras. 63-64, 70, and 97(d) and (f) above.

196 The Comité Européen des Assurances is a body representing the European insurance industry.

197 For a discussion of proposal forms see paras. 65-77, above.

198 At paras. 66 and 97(e) above.

199 The term "innocently" is not used in Article 2(2) of the draft directive but we use it here to distinguish a breach under Article 2(2) from the other ways in which the duty may be broken.

(ii) Under Article 2(3) he may have broken it and "may be deemed to have acted improperly";[200]

(iii) Under Article 2(4) he may have broken it with the intention of deceiving the insurer.

ıe consequences of breach will be different in each case.[201]

35. The experience of the English courts is that the ɔst usual case of non-disclosure is where the insured has ɐen neither fraudulent nor negligent. Indeed, the ɔrmulation of Article 2 at first sight also suggests that ınocent breaches under Article 2(2) will be the usual case ıd that breaches under Article 2(3) and 2(4) will be the xceptional cases. However we understand from the numerous ɐetings which have been held with the Commission of the uropean Communities in Brussels that Article 2(2) is only ıtended to cover exceptional cases and we therefore feel ıat the structure of Article 2(2), 2(3) and 2(4) is isleading. We understand that it is intended that a breach f duty under Article 2(1) will only come within Article 2(2) f it arises as a result of factors outside the control of he insured as, for example, where the letter disclosing the acts is lost in the post. If this is correct then innocent reaches and breaches where there is an intention to deceive he insurer will obviously be the exceptional cases and mproper breaches will be the usual situation. We shall be ealing with the provisions of Article 2 on this basis. nother problem is that it may be difficult to decide when

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00 The use of the word "improperly" in this context seems to be based on principles of German law whereby a breach of contract is committed only if in addition to breaking the contract the guilty party is "responsible" for his breach and he is only "responsible" for it in this sense if the breach has been committed by him "negligently or intentionally": see E.J. Cohn, Manual of German Law (2nd ed., 1968) Vol. 1, paras. 220-221.

01 See paras. 138-140, below.

the insured has broken the duty with the intention of deceiving the insurer. It is not clear whether the term "with the intention of deceiving the insurer" has the same meaning as "fraudulently". However, for the avoidance of doubt it seems preferable to use the latter term.

Discovery of new circumstances

136. The first part of Article 2(2)(a) envisages a situation in which there has been no breach of duty by the insured and in which circumstances which were unknown to both parties when the contract was concluded subsequently come to light. The consequences are the same as where there has been an innocent breach of duty by the insured.[202]

Burden of proof

137. The burden of proving improper or "fraudulent" conduct is on the insurer.[203] Article 2 is silent on the burden of proof where the breach is innocent.

Consequences of breach

138. Where the insured has broken the duty and may be deemed to have acted improperly the insurer has the option of terminating the contract or of proposing an amendment of its terms.[204] If the contract is terminated the insurer must make a proportionate refund of the premium in respect of the period for which cover has not been provided.[205] If the insurer proposes an amendment to the contract the insured may accept or reject it. If he rejects it or fails to reply within the time allowed the insurer may terminate the contract upon giving notice.[206]

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202 See para. 139, below.

203 Article 2(5).

204 Article 2(3).

205 Article 2(3)(b).

206 Article 2(3)(a).

139. Where the insured's breach of duty was innocent the insurer may propose an amendment of the terms of the contract but he is not entitled there and then to terminate the contract.[207] The procedure for proposing an amendment is identical with that outlined above.[208] If the insurer terminates the contract in accordance with the procedure for amendment he must make a proportionate refund of premium in respect of any period for which cover has not been provided.[209]

140. Where the insured has failed to comply with the duty with the intention of deceiving the insurer the latter may terminate the contract immediately and may retain any premiums already paid and collect any premiums still outstanding in respect of the "current insurance period".[210]

141. Time limits are specified within which each procedural step must be taken.[211] The provisions described above confer rights on the insurer in the event of a breach of the duty by the insured, but no provision is made for the situation where the insurer does not exercise his rights after becoming aware of the breach. Presumably if the time limits have expired without the insurer having exercised his rights he must be taken to have waived the insured's breach of his duty and the contract will continue as if there had been a disclosure of all material facts. In the next paragraph we consider the situation if a claim arises before the insurer has exercised his rights.

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207 Article 2(2)(a).

208 See para. 138, above.

209 Article 2(2)(b)(2).

210 Article 2(4)(b).

211 See Articles 2(2)(a), 2(2)(b), 2(3)(a) and 2(4)(a). Time starts to run against the insurer in respect of the first procedural step when he becomes aware of the breach.

The effect of a breach on claims

142. A loss may occur when there has been a breach of duty and the insurer has not exercised his rights to propose an amendment to the contract or to terminate it. Indeed the insurer will usually only become aware of the breach when a claim is made. Article 2 accordingly makes provision for the effect of the breach on the insurer's liability to pay the claim. Once again the effect will depend upon the nature of the insured's failure to comply with the duty.

143. Where the insured in breach may be deemed to have acted improperly, which as we have seen[212] appears to be treated as the usual case, he will only be entitled to a proportionate recovery of his claim. The proportion of the claim which he is entitled to recover will depend on the ratio between the premium actually paid by him and the premium which would have been charged had the true risk been known (the "notional premium").[213] This method of determining the amount which the insured is entitled to recover is known as the proportionality principle and it will operate in most cases where there has been a breach of duty followed by a claim. We have already referred to the difficulties of operating such a principle in this country and have expressed the provisional view that its introduction would not be a desirable innovation.[214]

144. Where the insured's breach was innocent, he is entitled to recover the whole of his claim subject only to the deduction of the difference between the premium actually paid and the notional premium.[215] If however the insured broke the duty with the intention of deceiving the insurer then the latter will not be liable for the payment of any part of a subsequent

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212 See para. 135, above.

213 Article 2(3)(c).

214 See paras. 52-57 and 97(b), above.

215 Article 2(2)(b)(3).

claim and may reclaim any payments already made by him to the insured.[216]

145. The present draft provisionally includes a clause (Article 2(6)) which gives the insurer the right to refuse payment of any part of a claim if he can prove that he would not, for various specified reasons,[217] have accepted the true risk at all. In these circumstances he will however be obliged to refund any premiums paid. Article 2(6) has been included in the present draft at the request of the C.E.A. We understand however that there is considerable opposition to it and it is by no means certain that it will survive. We have already discussed the drawbacks of such a provision;[218] however, it seems to us that the proportionality principle would in any event be unworkable in this country without it.

Our provisional view on Article 2

146. Our provisional view is that Article 2 is open to two major criticisms:

(a) the formulation of the Article as regards the various ways in which the duty may be broken is misleading and the ambit of each type of breach is not defined with precision;

(b) we doubt whether the proportionality principle could be made to work satisfactorily in practice in this country.[219]

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216 Article 2(4)(c).

217 "Either because of the nature of his instructions or his own internal risks, or as a result of the special conditions imposed by insurance technicalities...."

218 See para. 56, above.

219 See paras. 52-57, and 97(b), above.

(ii) An alternative to a system of warranties

Introduction

147. In Part III of this working paper we have considered two possible ways of reforming the law relating to warranties; the second of the two approaches (which we do not recommend) is the abolition of warranties and the introduction of a continuing duty on the insured to notify increases of risk to the insurer. This approach to reform is substantially that taken by Article 3 of the draft directive. We understand that Article 3 is not intended to co-exist with any system of warranties; its implementation would therefore presuppose the abolition of this system in English law. The Article contains detailed provisions concerning the insured's duty of notification, the various ways in which the duty may be broken, the consequences of breach in each case and effect of breach on subsequent claims. Article 4 deals with diminution of the risk and entitles the insured to terminate the contract if the insurer refuses to reduce the premium. The provisions of Articles 3 and 4, taken together, appear to be intended:

(a) to provide the insurer with all the information he needs for the continuous assessment of the risk throughout the term of the contract and for the corresponding adjustment of the premium as the risk changes from time to time during that period;

(b) to enable the insured to make a proportionate recovery of his claim where his breach of the continuing duty to notify increases in the risk does not justify the rejection of the whole of his claim;

(c) to prevent the insured from being obliged to continue to pay a premium that has become excessive because of a decrease in the risk.

48. These provisions form a marked contrast to English aw under which the insured's duty of disclosure only arises efore and at the making of the contract.[220] Thereafter the nsurer can, by the use of warranties with which the insured s bound strictly to comply, ensure that during the currency f the contract the circumstances material to the risk remain s disclosed at the time of its making. In English law breach f the duty of disclosure or breach of warranty entitles the nsurer to refuse payment of any part of a subsequent claim.[221] efore we consider the detailed provisions of Articles 3 and 4 e should point out that they appear to have been drafted to ater mainly for long-term contracts of insurance extending ver several years. Long-term cover is, as we have seen,[222] feature of Continental but not of English insurance practice. t is for consideration whether these provisions are appropriate, r appropriate to the same extent, for insurance contracts of nnual duration, which are the most usual type of insurance ontracts in this country.

rticle 3

he duty of notification

49. Article 3(1) provides that from the time the contract s entered into the insured is under a duty to notify the nsurer of any new circumstances or changes in circumstances of hich the insurer has requested notification in the contract. lthough not stated expressly, it is clear by implication[223] hat this duty is only to disclose new circumstances or changes

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220 See paras. 23-24 and 34, above.

221 See paras. 21-34, above for the present law as to non-disclosure and paras. 98-105, above for the present law as to breach of warranty.

222 See para. 111, above.

223 The Article is headed "Increase of risk" and these words or variations of them are repeated throughout the Article. See e.g. Article 3(1) (second paragraph), Article 3(2), Article 3(3) and Article 3(6)(c).

in circumstances which increase the risk to which the insurer is subject.[224] Where the increase in the risk has been brought about by the insured himself, he must give prior notification of it to the insurer; in all other cases notification must be made as soon as the insured becomes aware of the increase.[225] Upon receiving notification of any increase in the risk, or within a specified time thereafter, the insurer may propose that the terms of the contract be amended.[226] The effect of Article 3(1) is that throughout the term of the contract the insured is subject to a continuing duty to disclose the matters referred to in the contract.[227]

The ways in which the duty may be broken

150. Article 3 lays down three ways in which the duty of notification may be broken by the insured and these correspond with the analogous provisions of Article 2. For ease of reference we set them out again: the insurer may have broken the duty innocently,[228] he may have broken it and may be deemed to have acted improperly,[229] or he may have broken it with the

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224 However, Article 3(3) provides that a failure to notify "a new circumstance or a change in circumstances which is not liable to appreciably and permanently increase the risk and lead to an increase in the premium" will not produce any adverse legal consequences for the insured.

225 Article 3(1) (second paragraph); it seems therefore that the insured would not be in breach of his duty if he was aware of the new circumstances or change in circumstances but not aware that they constituted an increase in the risk.

226 Article 3(2); the procedure for amendment is set out in Article 2(2)(b): see para. 138, above.

227 The C.E.A. have proposed that the insured should be duty-bound to disclose every new occurrence or change of circumstances increasing the risk irrespective of whether disclosure has been requested in the contract; see paras. 109-114, above and para. 125(b), above for our criticisms of the continuing duty of disclosure.

228 See paras. 134-135.

229 Article 3(5).

intention of deceiving the insurer.[230] The consequences of breach will be different in each case.[231] As with Article 2, the most important of the three in practice will, we understand,[232] be the second, even though the provisions are again formulated in a way which suggests that breaches will generally be innocent, since the other degrees of failure to comply with the duty are treated as mere exceptions to this rule. The difficulties concerning the precise ambit of the general rule and of its exceptions[233] are again relevant.

Burden of proof

151. Article 3(7) provides that the burden of proving that the insured failed to comply with the duty in an improper or "fraudulent"[234] way will in general rest on the insurer. However, there is an exception where the increase in the risk has been brought about by the insured himself: in this case the burden of disproving improper or "fraudulent" conduct rests on him. Although the purpose of this exception is clearly to discourage the insured from taking positive steps to increase the risk and then failing to notify the insurer, we consider it undesirable as a matter of policy that the insured should be under an onus of disproving his own guilt.

The consequences of breach

152. The consequences of breach will be identical with those prescribed by Article 2 for each degree of non-compliance.[235]

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230 Article 3(6).

231 See para. 152, below.

232 See para. 135, above.

233 See para. 135, above.

234 This term was introduced at the request of the C.E.A. and its meaning appears to be the same as "with the intention of deceiving".

235 Save that, where the insured has broken the duty with the intention of deceiving the insurer, it seems that the insurer will not be entitled to reclaim any payments made to the insured prior to the breach: cf. Article 2(4)(c); see paras. 143-144, above.

The effect of a breach on claims

153. In cases where the insured has broken the duty and may be deemed to have acted improperly and a claim is made before the insurer has been able to terminate the contract or propose an amendment of its terms,[236] the proportionality principle in Article 2(3)(c) will again govern the insurer's liability to pay the claim. The difficulties to which we have already adverted[237] which are raised by the operation of this principle in the context of non-disclosure are equally applicable here. Another difficulty concerns the computation of the proportion of the actual premium to the notional premium when the increase in the risk occurs during the currency of the contract. How this would work is not clear. The notional premium is ex hypothesi only payable from the date when the risk increases and presumably for the purpose of the calculation the actual premium would have to be pro-rated over the period of the increased risk and compared with the notional premium for that period. We think that this formula would achieve the intended result,[238] but it does not add to the attraction of the principle.

154. The present draft again provisionally includes a clause (Article 3(8)) which gives the insurer the right to refuse

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236 As provided by Articles 3(5) and 2(3).

237 See paras. 52-56, above.

238 However, there is the difficulty of interpretation that Article 3(5) refers back to and incorporates Article 2(3)(c) which provides for the application of the proportionality principle to a claim made after the "improper" breach of the duty of disclosure by the insured. Article 2(3)(c) makes reference to "the premium paid and the premium that the policy holder should have paid...". Interpreted literally, pro-rating of the actual premium for the purpose of the calculation would appear not to be permitted. We think however that it must have been intended that Article 2(3)(c) should apply, mutatis mutandis, to the different circumstances envisaged by Article 3.

payment of any part of a claim if he can prove that he would not, for various specified reasons,[239] have accepted the true risk at all. This provision has again been introduced at the request of the C.E.A. It is however by no means certain that it will survive. For reasons already discussed in this working paper[240] our view is that such a provision is likely to work strongly to the disadvantage of the insured and is capable of abuse by insurers; however, it seems to us that the proportionality principle would in any event be unworkable in this country without it.

155. Article 3(6)(c) provides the insurer with the right to refuse payment of any part of a claim where the insured has acted with the intention of deceiving the insurer in failing to comply with his duty.

156. One drawback of the provisions of Article 3 is that they may cause injustice to the insured who is denied recovery of his claim, either wholly or in part, on the ground of his breach of duty, where the new circumstance or change of circumstances which he failed to disclose could have had no connection with the loss which actually occurred.[241]

Our provisional view on Article 3

157. In our provisional view, Article 3 is open to two major criticisms:

(a) it places upon the insured a continuing duty of disclosure during the term of the contract.

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239 "Either because of the nature of his instructions or his own internal rules, or as a result of the special conditions imposed by insurance technicalities...."

240 See paras. 55-56, above.

241 See paras. 121-123, above for our discussion of a similar deficiency in our present law of warranties and for our provisional recommendations.

We think that this would be unduly onerous on the insured and that it would deprive him of much of the security and peace of mind he is entitled to expect from a contract of insurance;

(b) it is by no means clear how its provisions will work in practice or whether they are appropriate for the general run of insurance contracts in this country.

Article 4

158. Whereas Articles 2 and 3 deal, either expressly or by implication, with increase of risk, Article 4 deals with diminution of the risk. It seems intended to provide a counter-balance to Articles 2 and 3 since it confers rights on the insured and obligations on the insurer rather than vice versa. The Article provides that the insured should be entitled "without compensation" to terminate the contract if, while it is on foot, the risk to which the insurer is subjected has diminished "appreciably and permanently" so as to justify a decrease in the premium and the insurer has refused to agree to such a reduction. The right to terminate the contract arises as soon as the insurer refuses to agree to the reduction or within a specified time of a request to this effect being made to the insurer. Provision is made for a proportionate refund of premium to be made to the insured where the contract has been terminated by him under the Article. The present draft includes a provision in square brackets that the Article should not apply in cases where the risk diminishes after a claim has been made. This provision was included at the request of the C.E.A. and it is not clear whether it will be incorporated in the final draft.

159. There may well be disagreement between the insured and the insurer as to the extent of the decrease in the premium which is justified. No machinery is provided for the

resolution of such a dispute. It is also not apparent to us why the making of a claim prior to diminution of the risk should deprive the insured of his rights of termination under the Article.

Our provisional conclusions on the draft directive as an alternative approach to non-disclosure and warranties

160. We recognise that in the draft directive an attempt has been made to strike a fair balance between the interests of the insurer and those of the insured. However, we envisage major difficulties if these proposals were to be adopted in this country.

161. The proposals in Article 2 seem to us workable only on the assumption that there is in existence a comprehensive system of tariffs so that generally the notional premium can readily be ascertained. There is no such system of tariffs in this country but our provisional view is that the proposals in Article 2 would be unsatisfactory even if there were. The most important consideration which has led us to this view is that the insurer's right, under Article 2(6), to contend that he would not have taken the risk at all is vital to the operation of Article 2 yet at the same time it impairs the most valuable feature of the proposals by re-introducing the "all or nothing" result in certain circumstances.

162. Similar considerations apply to Article 3.[242] Furthermore, whereas under our law the rights and obligations of the parties are frozen for the period of insurance (usually a year), under Article 3 the insured has obligations imposed on him after he has concluded the contract, which we think would be undesirable.

163. Articles 2 and 3 provide for the operation of complicated procedures during the currency of the contract which would increase administrative costs and might lead to an increase in premium.

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242 See paras. 153-154, above. See also para. 153, above for the additional problem of how to assess the notional premium under Article 3.

164. Articles 3 and 4 envisage the adjustment of the premium from time to time if the risk increases or decreases during the currency of the contract. This would be difficult to operate under our system because of the absence of fixed tariffs.

165. In general, we think that the draft directive would be liable to cause administrative difficulties and additional costs and also to lead to uncertainty and increased litigation.

166. Comments are invited on the draft directive and in particular whether and how it would work in practice in England.

PART V - MISCELLANEOUS MATTERS

167. In this Part of the working paper we deal with two miscellaneous matters in respect of which we are making no detailed provisional recommendations. They are:

(i) the relationship between our provisional recommendations as to non-disclosure and warranties and the existing law of misrepresentation and fraud; and

(ii) whether our provisional recommendations should apply to contracts of re-insurance.

(i) Misrepresentation and fraud

168. In Parts II and III of this working paper we put forward our provisional recommendations for reform of the law relating to non-disclosure and warranties respectively. It is necessary for us to examine briefly the relationship between the rights and remedies under our recommendations and the rights and remedies under the existing law of misrepresentation and fraud.

(a) Non-fraudulent misrepresentation

169. A breach by the insured of the duty of disclosure may also amount to a positive misrepresentation of existing fact. This is likely to be the case where the breach consists of the giving of inaccurate information in answer to a material question in the proposal form.[243] We envisage a situation in which the insurer might have the alternative of pursuing his remedies (a) under our provisional recommendations for non-disclosure, or (b) under the existing law for misrepresentation. He might think it advantageous to seek his remedies under (b) rather than those under (a). Our provisional recommendations in regard to non-disclosure are designed to strike a fair

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243 See para. 30, above.

balance between the interests of the insurer and of the insured and we think that this balance might be upset if the insurer were entitled to pursue his alternative remedies for misrepresentation. Our view is therefore that in such a situation the insurer should be confined to the rights and remedies provided under our provisional recommendations in regard to non-disclosure.

(b) Fraud

170. The circumstances in which an insured supplies information to his insurer in pursuance of his duty of disclosure may be such as to fall within the rules governing fraudulent misrepresentations. The insurer might in such cases have the alternative of pursuing his rights and remedies under our provisional recommendations in regard to non-disclosure or of pursuing his rights and remedies for fraud. He might regard the latter as more advantageous than the former. Our provisional view is that the presence of fraud is an essential distinction and that it would be unjust to deprive the insurer in such cases of his alternative rights and remedies in fraud.

171. We are aware that the insured may also make fraudulent misrepresentations or otherwise act fraudulently when he makes a claim but we do not intend to deal with this topic at this stage and are therefore omitting it from this working paper.

(ii) Contracts of re-insurance

172. When an insurer underwrites a risk he may contract with third parties (known as re-insurers) to indemnify him against any liability in respect of the risk: this is a contract of re-insurance. There are also other types of contracts such as "cessions" and "treaties", whereby insurers

ay agree to "cede" part of the premium and of the liability o other insurers, to which similar considerations apply as o contracts of re-insurance. It is necessary for us to onsider whether the provisional recommendations in this orking paper are appropriate for such contracts.

73. The parties to such contracts will almost always be nsurers themselves; as such they carry on business in a arket governed by well-known and long-standing rules of aw and practice. The considerations which persuaded us hat MAT should be excluded from the scope of this working aper[244] therefore apply a fortiori to contracts of e-insurance and similar contracts. Furthermore in our view he provisional recommendations set out in Parts II and III f this working paper may well be inappropriate for such ontracts.

74. We understand that it is not intended that contracts f re-insurance should fall within the ambit of the draft irective.

75. We have therefore concluded that the proposals for eform in this working paper should not apply to contracts of e-insurance and similar contracts. Comments are invited.

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244 See paras. 15-17, above.

PART VI - OUR GENERAL COMMENTS ON THIS WORKING PAPER

176. The purpose of this working paper is to consider the present law, and to suggest reforms of it, in relation to the rights of insurers to repudiate contracts of insurance and to reject claims on the grounds of non-disclosure of material facts and breaches of warranties by the insured. Our examination of the law and proposals for reform are designed to operate in all fields of insurance other than marine, aviation and transport ("MAT"),[245] and re-insurance and similar contracts.[246]

A summary of our provisional conclusions and recommendations in relation to non-disclosure is set out in paragraph 97(a) to (o) at the end of Part II, and in relation to breaches of warranties in paragraph 125(a) to (g) at the end of Part III.

We were asked to deal with these important aspects of our terms of reference[247] as a matter of urgency. We have therefore been unable to deal in this working paper with "special conditions, exceptions and terms" in our terms of reference, but our consideration of non-disclosure and breaches of warranties has also touched on aspects of "misrepresentation by, or on behalf of, the insured", and our examination of the draft directive[248] has involved some consideration of "increase and decrease of risks covered".

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245 See paras. 15-17, above.

246 See paras. 172-175, above.

247 See para. 1, above.

248 See paras. 11-13, above, and Part IV, above; see also Appendix B.

177. It seems to us that the need for reform of insurance law in the fields of non-disclosure and breaches of warranties covered by this working paper is not open to doubt. The draft directive[248] provided the immediate reason for the reference to us, but the need for reform in these fields is demonstrated by the Fifth Report of the Law Reform Committee,[249] by the many judicial and academic criticisms of the present law referred to in Part II of this working paper, and by the insurance industry's Statements of Insurance Practice[250] which show that the practices of insurers are in many respects more favourable to the insured (though only as a matter of discretion; not of right) than under the law in its present state.

178. The difficult balance between the interests of the insurer and of the insured, and the different ways of striking this balance are reflected in every code or system of insurance law or practice which we have encountered. Notable examples referred to in this working paper are the draft directive,[251] the law in other common law jurisdictions,[252] the law in France and West Germany,[253] and the Statements of Insurance Practice.[254] Our provisional conclusions and recommendations for the reform of our law in these fields find echoes in all of them. In putting them forward we have had four principal aims in mind. First, to reform our law to the extent to which it appears to us to be in need of reform in these fields. Secondly, to propose reforms which strike a fair balance between the interests of insurers and of the insured, and not to shrink from radical proposals where these appear to be justified. Thirdly, to propose reforms which reflect the spirit and broad aims of the

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249 See para. 3, above.
250 See paras. 4-10, above, and Appendix A.
251 See Part IV and Appendix B.
252 See Appendix C, Part I.
253 See Appendix C, Part II.
254 See paras. 4-10, above, and Appendix A.

draft directive.[255] Fourthly, to propose reforms which are consistent with the general principles of English law and insurance practice, bearing in mind that both our law and practice differ from those of our E.E.C. partners. We see no reason why the implementation of our proposals would lead to any significant increase in premiums.

255 See Part IV and Appendix B.

APPENDIX A

STATEMENT OF INSURANCE PRACTICE

This Statement is restricted to non-life insurances of policyholders resident in the UK and insured in their private capacity only.

1. Proposal Forms

(a) The declaration at the foot of the proposal form should be restricted to completion according to the proposer's knowledge and belief.

(b) If not included in the declaration, prominently displayed on the proposal form should be a Statement:-

(i) drawing the attention of the proposer to the consequences of the failure to disclose all material facts, explained as those facts an insurer would regard as likely to influence the acceptance and assessment of the proposal;

(ii) warning that if the proposer is in any doubt about facts considered material, he should disclose them.

(c) Those matters which insurers have found generally to be material will be the subject of clear questions in proposal forms.

(d) So far as is practicable, insurers will avoid asking questions which would require expert knowledge beyond that which the proposer could reasonably be expected to possess or obtain or which would require a value judgment on the part of the proposer.

(e) Unless the prospectus or the proposal form contains full details of the standard cover offered, and whether or not it contains an outline of that cover, the proposal form shall include a statement that a copy of the policy form is available on request.

(f) Unless the completed form or a copy of it has been sent to a policyholder, a copy will be made available when an insurer raises an issue under the proposal form.

2. Claims

(a) Under the conditions regarding notification of a claim, the policyholder shall not be asked to do more than report a claim and subsequent developments as soon as reasonably possible except in the case of legal processes and claims which a third party requires the policyholder to notify within a fixed time, where immediate advice may be required.

(b) Except where fraud, deception or negligence is involved, an insurer will not unreasonably repudiate liability to indemnify a policyholder:-

(i) on the grounds of non-disclosure or misrepresentation of a material fact where knowledge of the fact would not materially have influenced the insurer's judgment in the acceptance or assessment of the insurance;

(ii) on the grounds of a breach of warranty or condition where the circumstances of the loss are unconnected with the breach.

The previous paragraph 2(b) does not apply to Marine and Aviation policies.

3. Renewals

Renewal notices should contain a warning about the duty of disclosure including the necessity to advise changes affecting the policy which have occurred since the policy inception or last renewal date, whichever was the later.

4. Commencement

Any changes to insurance documents will be made as and when they need to be reprinted, but the Statement will apply in the meantime.

5. EEC

This Statement will need reconsideration when the EEC Contract Law Directive is taken into English/Scots Law.

TATEMENT OF LONG-TERM INSURANCE PRACTICE

iis statement relates to long-term insurance effected by
ıdividuals resident in the UK in a private capacity.
lthough the statement is not mandatory, it has been
ecognised by members of the LOA and ASLO as an indication of
ısurance practice, it being understood that there will
ɔmetimes be exceptional circumstances where the statement
ɔuld be inappropriate.

ıdustrial life assurance policyholders are already protected
ɣ The Industrial Assurance Acts 1923 to 1968 and regulations
ssued thereunder, to an extent not provided for ordinary
ranch policyholders. The statement will, therefore, be
ɔdified in its application to industrial assurance business
ı discussion with the Industrial Assurance Commissioner.

ife assurance is either very largely or else entirely a
ıtual enterprise and the aim of the industry in recent years
as been to reduce to a minimum the formalities - and
ıerefore the expense to the policyholder - involved in
ssuing a new life policy subject only to the need to protect
ıe general body of policyholders from the effects of non-
isclosure by a small minority of proposers.

. Claims

(a) An insurer will not unreasonably reject a claim. (However, fraud or deception will, and negligence or non-disclosure or misrepresentation of a material fact may, result in adjustment or constitute grounds for rejection). In particular, an insurer will not reject a claim on grounds of non-disclosure or misrepresentation of a matter that was outside the knowledge of the proposer.

(b) Under any conditions regarding a time limit for notification of a claim, the claimant will not be asked to do more than report a claim and subsequent developments as soon as reasonably possible.

. Proposal forms

(a) If the proposal form calls for the disclosure of material facts a statement should be included in the declaration, or prominently displayed elsewhere on the form or in the document of which it forms part:-

(i) drawing attention to the consequences of failure to disclose all material facts and explaining that these are facts that an

insurer would regard as likely to influence the assessment and acceptance of a proposal;

(ii) warning that if the signatory is in any doubt about whether certain facts are material, these facts should be disclosed.

(b) Those matters which insurers have commonly found to be material should be the subject of clear questions in proposal forms.

(c) Insurers should avoid asking questions which would require knowledge beyond that which the signatory could reasonably be expected to possess.

(d) The proposal form or a supporting document should include a statement that a copy of the policy form or of the policy conditions is available on request.

(e) A copy of the proposal should be made available to the policyholder when an insurer raises an issue under that proposal - information not relevant to that issue being deleted where necessary to preserve confidentiality.

3. Policies and accompanying documents

Life assurance policies or accompanying documents should indicate:-

(a) the circumstances in which interest would accrue after the assurance has matured; and

(b) whether or not there are rights to surrender values in the contract and, if so, what those rights are.

(Note: The appropriate sales literature should endeavour to impress on proposers that whole life or endowment assurance is intended to be a long-term contract and that surrender values, especially in the early years, are frequently less than the total premiums paid.)

4. Commencement

Any changes to insurance documents will be made as and when they need to be reprinted but the statement will apply in the meantime.

APPENDIX B

DRAFT COUNCIL DIRECTIVE ON THE CO-ORDINATION OF LAWS, REGULATIONS AND ADMINISTRATIVE PROVISIONS RELATING TO INSURANCE CONTRACTS

5TH REVISION (FOLLOWING THE 24TH MEETING OF THE WORKING PARTY ON INSURANCE CONTRACTS, HELD ON 21 AND 22 JUNE 1977)

* * *

Article 2

Declaration of risk

1. When concluding the contract, the policy-holder shall declare to the insurer any circumstances of which he is aware which may influence the insurer's assessment or acceptance of the risk. The policy-holder shall not be obliged to declare to the insurer circumstances which are already known to the latter or which are common knowledge.

   Any circumstance in respect of which the insurer has asked specific questions in writing shall, in the absence of proof to the contrary, be regarded as influencing the assessment and acceptance of the risk. The policy-holder must provide precise and complete answers.

2. (a) If circumstances which were unknown to both parties when the contract was concluded come to light subsequently or if the policy-holder has failed to fulfil the obligation referred to in paragraph 1, the insurer shall be entitled, within a period of two (three) months from the date on which he becomes aware of the fact, to propose an amendment to the contract.

   (b) 1. The policy-holder shall be entitled to a period of 15 days from the date on which he receives the proposal for an amendment in which to accept or reject it. If the policy-holder rejects the proposal or fails to reply within the above time limit, the insurer may terminate the contract within a period of 8 days [one month] by giving 15 days notice.

2. If the contract is terminated, the insurer shall refund to the policy-holder the proportion of the premium payable in respect of the period for which cover is not provided.

3. If a claim arises before the contract is amended or before termination of the contract has taken effect, the insurer shall provide the agreed cover less the difference between the premium paid for the current insurance period and the premium which should have been paid having regard to the increase in the risk.

3. If the policy-holder has failed to fulfil the obligation referred to in paragraph 1 and may be deemed to have acted improperly, the insurer may terminate the contract or propose an amendment to it.

(a) The insurer shall choose either to terminate the contract or to propose an amendment to it within two (three) months from the date on which he becomes aware of that fact. Termination shall take effect fifteen days after the date on which the policy-holder is notified thereof at his last known address.

If the insurer has proposed an amendment to the contract, the policy-holder shall be entitled to accept or reject it within 15 days from the date on which he receives the proposal for an amendment. If the policy-holder refuses the proposal or fails to reply, the insurer may terminate the contract within eight days [one month] by giving fifteen days notice.

(b) If the contract is terminated the insurer shall refund to the policy-holder the proportion of the premium payable in respect of the period for which cover is not provided.

(c) If a claim arises before the contract is amended or before termination of the contract has taken effect, the insurer shall be liable to provide only such cover as is in accordance with the ratio between the premium paid and the premium that the policy-holder should have paid if he had declared the risk correctly.

4. If the policy-holder has failed to fulfil the obligation referred to in paragraph 1 with the intention of deceiving the insurer, the latter may terminate the contract.

(a) The insurer shall take such action within two [three] months from the date on which he becomes aware of such fact.

(b) If he terminates the contract, the insurer shall be entitled to retain any premiums already paid and to collect any premium payable in respect of the current insurance period.

(c) He shall not be liable for payment in respect of any claim; he shall be entitled to reclaim any payments already made.

. In the cases referred to in paragraphs 3 and 4, the burden of proof of fraudulent or improper conduct on the part of the policy-holder shall rest with the insurer.

. [Where the insurer can prove that he would in no circumstances have accepted the true risk, either because of the nature of his instructions or his own internal risks, or as a result of the special conditions imposed by insurance technicalities, he shall be released from all liability in the event of a claim, and shall refund the amount of the premiums paid].

Article 3

Increase of risk

1. From the time when the contract is signed, the policy-holder shall declare to the insurer any new circumstances or changes in circumstances of which the insurer has requested notification in the contract.

   Such declaration shall be made [before] not later than the time when the risk increases where this is attributable to the policy-holder; in all other cases, it should be made immediately after the policy-holder becomes aware of the increase.

2. The insurer may, within two [three] months of the date on which he was notified of the increase of the risk, propose an amendment to the contract in accordance with the procedure laid down in Article 2(2)(b).

3. If the policy-holder has failed to fulfil the obligation referred to in paragraph 1, such failure to give notice shall not give rise to any penalty where it relates to a new circumstance or change in circumstances which is not liable to appreciably and permanently increase the risk and lead to an increase in the premium.

4. If the policy-holder has failed to fulfil the obligation referred to in paragraph 1, the insurer may, within two [three] months of the date on which he becomes aware of such fact, propose an amendment to the contract in accordance with the procedure laid down in Article 2(2)(b).

5. If the policy-holder has failed to fulfil the obligation referred to in paragraph 1 and may be deemed to have acted improperly, Article 2(3) shall apply.

6. If the policy-holder has failed to fulfil the obligation referred to in paragraph 1 with the intention of deceiving the insurer, the latter may terminate the contract.

   (a) The insurer shall take such action within two [three] months from the date on which he becomes aware of such fact;

(b) If he terminates the contract the insurer shall be entitled to retain any premiums already paid and to collect any premium payable in respect of the current insurance period;

(c) The insurer shall not be liable in respect of any claim arising after the increase of the risk.

7. The burden of proof of fraudulent or improper conduct on the part of the policy-holder shall rest with the insurer in the cases referred to in paragraphs 5 and 6, unless the increase is attributable to the policy-holder's own conduct.

8. [Where the insurer can prove that he would in no circumstances have accepted the true risk, either because of the nature of his instructions or his own internal rules, or as a result of the special conditions imposed by insurance technicalities, he shall be released from all liability in the event of a claim and shall refund a proportional amount of the premiums paid in respect of the period following the increase of the risk].

Article 4

If, while the contract is in force, the risk has diminished appreciably and permanently, and if this justifies a reduction in the premium, the policy-holder shall be entitled to terminate the contract without compensation if the insurer does not consent to reduce the premium proportionately.

The right to terminate the contract shall arise immediately the insurer refuses to reduce the premium or, where he fails to reply to the policy-holder's proposal, after a period of 15 days following such proposal.

Where the contract is terminated, the insurer shall refund to the policy-holder a proportion of the premium corresponding to the period for which cover is not provided.

[This provision shall not apply in cases where the risk diminishes after a claim has arisen].

APPENDIX C

I THE LAW RELATING TO NON-DISCLOSURE AND WARRANTIES IN OTHER COMMON LAW JURISDICTIONS

Non-disclosure

1. The duty of a proposer for insurance to disclose all material facts is found in all common law countries, though the scope of the duty is modified substantially in the United States and slightly in Canada. Following English authorities, the prevailing weight of case-law elsewhere supports the proposition that material facts are those which a prudent or reasonable insurer would consider material and that innocent as well as fraudulent or negligent non-disclosure renders the policy voidable at the option of the insurer.[1]

(a) United States of America

2. Only in the United States is the law of non-disclosure generally different. In non-marine insurance[2] only the intentional concealment of a known material fact or an actual misrepresentation gives the insurer the right to avoid the policy.[3] There is accordingly no general duty of disclosure.

(b) Canada

3. In general the duty to disclose is the same as in England. However, in relation to fire insurance only there is in most provinces a modified duty, existing by virtue of statutory conditions required in fire policies. In this case only a misrepresentation or a fraudulent concealment will avoid the policy.[4]

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1 See e.g. Babatsikos v. Car Owners' Mutual [1970] V.R.297. The Australian Law Reform Commission is examining aspects of insurance law, and the duty of disclosure is among those topics which it has under consideration - see Issues Paper No.2, Insurance Contracts, (June 1977) pp.20-25.

2 In marine insurance there is a full duty of disclosure: see Sun Mutual Ins. Co. v. Ocean Ins. Co. 107 U.S. 485 (1882).

3 See e.g. Sebring v. Fidelity-Phenix Ins. Co., 255 N.Y. 382 (1931); Vance on Insurance (3rd ed.) pp. 370 et seq.

4 Taylor v. London Ass. Corpn. [1935] S.C.R. 422.

Warranties

4. The strict law of warranties survives totally unchallenged in only a few countries other than the United Kingdom. The following are examples of some of the enacted reforms.

(a) Australia

5. There is legislation of general effect regarding life insurance. Section 84 of the Life Insurance Act 1945-1973 (Commonwealth) provides that only material warranties are actionable, except in the case of fraud, and even a material mis-statement can found avoidance of the policy only within three years of its being made. Section 83 of that Act deals with the particular problem of mis-statement of age, which by itself will never avoid a policy, the section providing in effect for the operation of the proportionality principle to take account of the true age. Presumably this presents little difficulty in this field where actuarial principles would be applied.

6. In the field of non-life insurance only the State of Victoria has a provision[5] specifically aimed at warranties; this provision prevents the insurer from relying on immaterial warranties unless he can establish fraud. In New South Wales, however, the court may relieve an insured from breach of a warranty (or of any other term of the contract) if the insurer could not be said to have been prejudiced by the breach.[6]

7. Both statutes requiring materiality apply only to mis-statements made on a proposal form or on any other document leading to the contract. Warranties in the body of the policy therefore may still be effective regardless of materiality, and there is no requirement of a connection between breach and a loss. The New South Wales provision applies to all warranties and clearly could be effective to prevent reliance on breach of a material warranty where there is no connection between the breach and a loss.

(b) Canada

8. There is neither general nor any uniform legislation. Often warranties are permitted only if material to the risk.[7] Equally though, it seems that in some Provinces and in relation to particular risks the law of warranties is as in this country.

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5 Instruments Act 1958, s.25.

6 Commercial Transactions (Miscellaneous Provisions) Act 1974, s.6.

7 See e.g. Insurance Act 1970, s.98(5) (Ontario).

(c) New Zealand

9. Legislation has recently been enacted[8] which introduces reforms corresponding in all material respects with the provisions in the Australian Life Insurance Act and the Victorian Instruments Act.

(d) South Africa

10. Section 63(3) of the Insurance Act 1943[9] provides that a misrepresentation made to an insurer is actionable only if material "whether or not such representation has been warranted to be true". Arguably this applies only to statements which, but for the presence of a "basis of the contract" clause, would be mere representations, and hence not to warranties contained in the body of an insurance policy.[10]

(e) United States of America

11. In a majority of States legislation has reformed the law on warranties. Not all statutes, however, follow the same pattern. Most turn warranties into representations and thus require them to be material.[11] Some require a causal connection between a breach of warranty and a loss before the breach is operative.[12] Frequently life policies are made statutorily incontestable after a certain period, and in some States the mis-statement of age by an applicant for life insurance will not avoid the policy, but brings into operation the proportionality principle; the insured's representatives are entitled to the amount which the premium paid would have purchased had the age been correctly stated.[13]

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8 Insurance Law Reform Act 1977, ss. 4-7.

9 Introduced by Insurance Amendment Act 1969, s.19.

10 See G. Gordon, The South African Law of Insurance (3rd ed.) p.205.

11 e.g. New York Insurance Law, s.149.

12 e.g. Iowa Insurance Code, §. 515.101.

13 e.g. New York Insurance Law, s.155. (See comment in paragraph 5 above).

II THE LAW RELATING TO NON-DISCLOSURE AND WARRANTIES IN FRANCE AND WEST GERMANY

(a) France

12. The French law regulating the contract of insurance as between the insurer and the insured is contained in the Law of 13 July 1930, as amended by a Decree of 16 July 1976. The Decree, known as the "Code des Assurances", is a consolidating measure as well, and the following exposition is based on its provisions.

13. Non-disclosure

Article L 113-2 of the Code provides that the insured is obliged to declare accurately, at the time of conclusion of the contract, all circumstances known to him which are calculated to affect the assessment of the risk. According to annotations in a standard edition of the Code[14] the French courts have interpreted the last part of this provision as meaning circumstances which the insured ought to know are capable of leading the insurer either to refuse the risk or to charge a higher premium.

14. Article L 113-9 provides that, if the insured is in breach of the obligations in Article L 113-2, either because he fails to disclose all material circumstances known to him or because he discloses them inaccurately (but has not in either case acted fraudulently) the insurer does not automatically have the right to repudiate the contract of insurance. If the insured's breach of obligation is discovered before any loss, the insurer may either rescind the contract on giving notice to the insured or may affirm the contract in consideration of an increase of premium. If, however, the insured's breach of obligation is discovered only after a loss, the insurer is only bound to pay that proportion of the loss which the premium paid bears to that which would have been payable if the risk had been completely and accurately described. Annotations to the Code[15] indicate that the amount of the "notional premium" is a question of fact, to be determined equitably by the courts. We understand that the courts' task is made easier by the existence in France of a comprehensive system of fixed tariffs for premiums corresponding to the circumstances of the risks to be covered. Annotations to Article L 113-9 indicate that the question whether the circumstance concealed or misrepresented had any connection with the loss is irrelevant to the insurer's rights[16].

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14 Annotated Edition of the Code des Assurances (1976), published by L'Argus, Paris at p. 11.

15 Ibid., p. 15.

16 Ibid., p. 15.

Fraudulent concealment and misrepresentation

15. Article L. 113-8 provides that the fraudulent concealment or misrepresentation of a material circumstance by the insured renders the contract of insurance void irrespective of whether the circumstance concealed or misrepresented had any connection with the loss.

The duty to declare increases in the risk

16. By Article L 113-4 the insured is under a duty to inform the insurer of any increase in the risk occurring during the currency of the contract where knowledge of the increased risk would have affected the insurer's assessment of the risk. The insured's duty of notification differs according to whether or not the increase in the risk was brought about by the insured's own act. In either case the insurer may terminate the contract or propose a new premium. If the proposed new premium is not accepted by the insured, the policy is terminated. The insurer loses the right to terminate the contract or to propose a new premium if, with knowledge of the insured's breach of duty, he affirms the contract by, for example, paying a claim or continuing to accept premiums[17].

Decrease in the risk

17. Article L 113-7 provides that if during the currency of the contract the risk decreases the insured may rescind the contract if the insurer does not agree to an appropriate reduction in the premium.

General

18. Again it is important to realise that the above provisions must be interpreted in the context of a system for administrative control of insurance. The basic law governing the organisation and control of insurance supervision is the Statutory Decree of 14 June 1938. The aim of the Decree is stated to be to ensure that contracts of insurance are properly performed. To this end all printed material which is to be distributed to the public or to

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17 For a general discussion of the provisions of French law as to the insured's duty of disclosure see Picard and Besson Les Assurances Terrestres en Droit Francais (4th ed., 1975-1977) Vol. I (1975) pp. 126-171. In Vol. II (1977) at pp. 457-461 there is a discussion of Articles 2-4 of the draft directive which supports the contention that these Articles are based substantially on French law.

policy holders must be submitted to the Minister of Finance for approval. This includes general policy conditions, proposal and acceptance forms and prospectuses. The Minister is authorised to prescribe modifications to make the forms comply with the law. Control in practice has been concerned mainly with the general policy terms. Under the ordonnance of 29 September 1945 the Minister is authorised to impose upon insurance companies the use of standard policy clauses, but it appears that this power has not yet been exercised.[18]

(b) West Germany

19. The German law regulating the contract of insurance as between the insurer and the insured is contained in the Versicherungsvertragsgesetz (the Insurance Contract Law) (VVG) of 30 May 1908, as amended by various laws and regulations between 1911 and 1967.

Non-disclosure

20. Article 16 of the VVG imposes a duty on the insured to disclose to the insurer, at the time when the contract is made, all material circumstances known to him. A circumstance is material if it is of a nature to have an influence on the insurer's decision whether to enter into the contract at all, or whether to do so on the agreed terms. A fact as to which the insurer has asked a written question is deemed to be material. Breach of this duty by the insured gives the insurer the right to repudiate the policy. The insurer may not however repudiate the policy if to his knowledge the insured's failure to disclose material circumstances was not the insured's fault[19]. Article 18 of the VVG provides that if the insurer has assessed the risk on the basis of the insured's answers to written questions he may only repudiate the policy for the non-disclosure of a fact outside the ambit of any of the written questions in the event of the insured's fraud.

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18 For administrative control of insurers in France generally, see Kimball and Pfennigstorf, "Administrative Control of the Terms of Insurance Contracts:- A Comparative Study" (1965) 40 Indiana L.J. 143 at 180 and 206.

19 Article 16(2) provides inter alia that the insurer is entitled to repudiate the policy if the insured's failure to disclose a material circumstance is due to his having "fraudulently avoided knowledge of the circumstance".

21. Article 21 of the VVG provides that if the insurer repudiates the policy after a loss has occurred he may not reject a claim if the circumstance which the insured failed to disclose had no causal connection with the loss.

22. The VVG also makes provision for the insurer's right to repudiate the policy for misrepresentation by the insured.[20] In addition it preserves the insurer's right to repudiate the policy on the ground of fraud.[21]

Breach of warranty

23. Article 6 of the VVG provides that a breach of warranty (Obliegenheit) only entitles the insurer to reject a claim arising from a loss occurring after the breach if the insured can be considered to be at fault in breaking the warranty and if there was a causal connection between the breach and the loss or the amount of the loss.

24. The VVG also makes provision for the effect of an increase or decrease in the risk during the term of the insurance contract.[22]

Procedure for repudiation

25. Article 20 of the VVG lays down the procedure to be followed by the insurer when he repudiates the policy. It also sets out some of the parties' obligations arising from repudiation.

General

26. It is important to realise that the above provisions must be understood within the context of:-

(a) the general German law of contracts and in particular its provisions relating to breach[23]; and

(b) the law relating to insurance supervision.[24]

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20 See Article 17.

21 See Article 22.

22 See Articles 23-29 and 41a respectively.

23 For a discussion of the German law on breach of contract see E.J. Cohn, Manual of German Law (2nd ed., 1968) Vol. 1 pp. 117-124. A brief description of the doctrine of breach in German law is given in the working paper at n.200.

24 A full description of the system of administrative control over the insurance industry is contained in Kimball and Pfennigstorf "Administrative Control of the Terms of Insurance Contracts:- A Comparative Study" (1965) 40 Indiana L.J. 143 at 177 and 182.

The latter is the Versicherungsaufsichtsgesetz (VAG) of 1901. After the formation of the West German Federal Republic in 1949 an ancillary law was passed in connection with insurance supervision; this was the Bundesaufsichtsgesetz (BAG) 1951. The BAG was mainly concerned with the setting up of a Federal Insurance Department. Under the VAG an insurance company applying to the German Federal Insurance Department for a licence to do business must also supply the Department with a plan of operation, which explains the legal, economic and financial basis for its business. Among other things the plan of operation must contain the general terms of insurance policies to be issued by the company. These "general policy conditions" in practice conform to standard clauses which are used throughout the industry. The Federal Insurance Department has been responsible for the development of these standard clauses in conjunction with the insurance industry. If an insurance company wishes to alter its existing policy conditions or introduce new ones it must first obtain the approval of the Federal Insurance Department. The general policy conditions must also meet certain minimum statutory requirements.